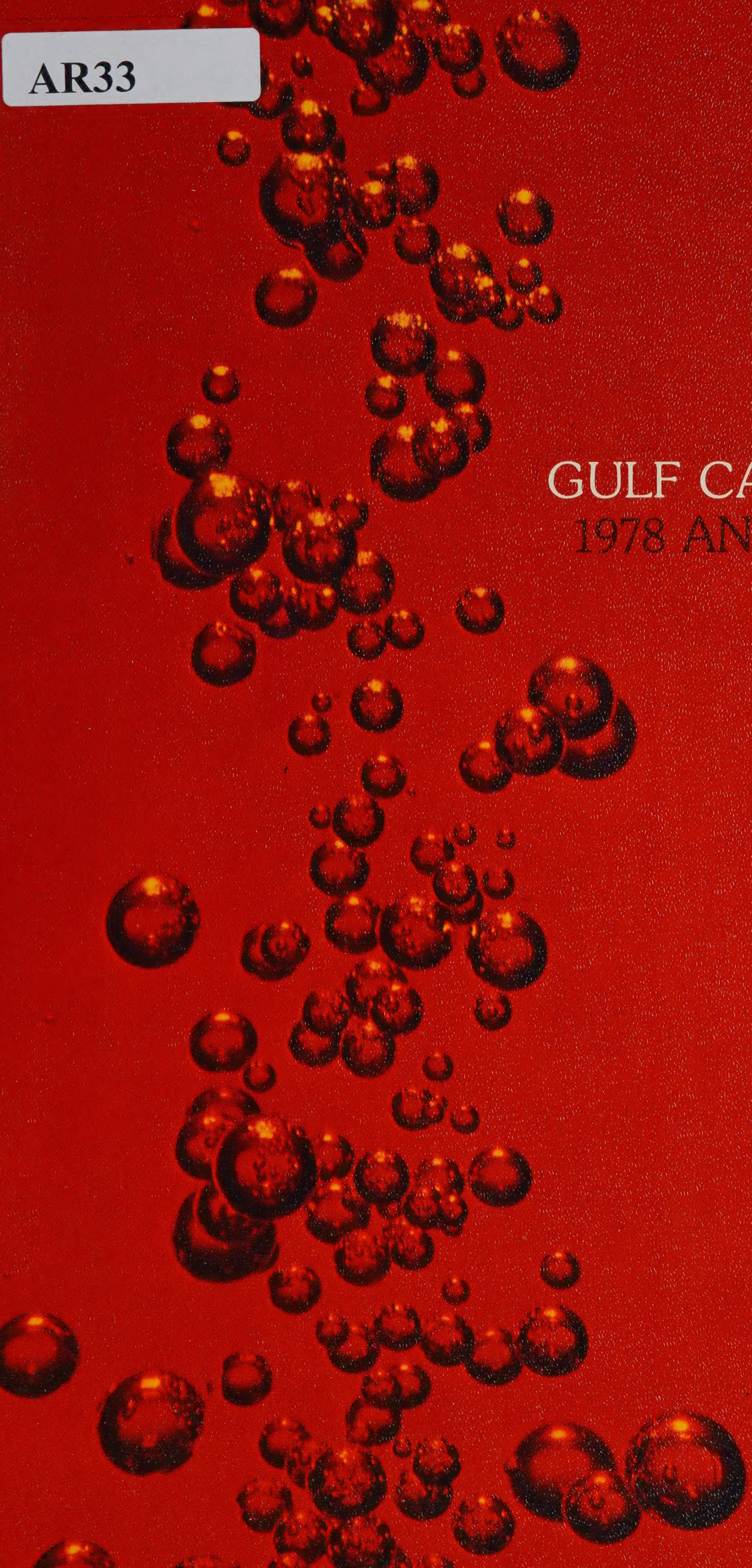


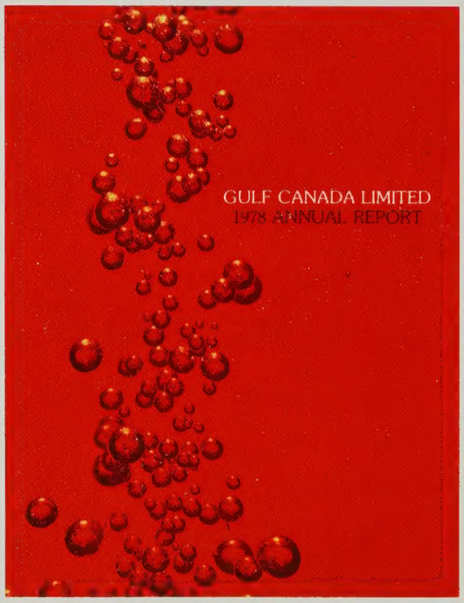
GULF CANADA LIMITED
1978 ANNUAL REPORT

Gulf Canada Limited 1978 Annual Report

Contents

Annual Meeting
The Annual Meeting of Shareholders will be held in the Concert Hall of the Royal York Hotel, Toronto, at 2:00 p.m. E.S.T., Thursday, April 26, 1979.

Disponible en français sur demande.



Front Cover
While production at Gulf Canada's new $213-million lubricating oil facility at Clarkson refinery commenced early in 1979, exhaustive testing at the Corporation's Research Centre had already confirmed the quality of the finished products. During tests to establish anti-foaming characteristics of the new motor oils, air bubbles created thousands of impressionistic patterns similar to the cover photo.

The year in brief

Financial	1978	1977
	Millions of dollars	
Earnings for the year	$ 182.9	$ 185.0
Taxes and other government revenues generated	$ 790.6	$ 793.6
Total dividends declared	$ 51.9	$ 49.2
Shareholders' equity at year-end	$1,419.0	$1,288.0
Capital expenditures	$ 369.8	$ 385.1
Working capital	$ 482.4	$ 538.4
Long-term liabilities	$ 350.1	$ 332.7
Return on average capital employed	9.8%	11.4%
Per Share Data		
Earnings for the year	$ 4.02	$ 4.07
Total dividends declared	$ 1.14	$ 1.08
Shareholders' equity at year-end	$ 31.19	$ 28.31
Operating		
	Barrels per day	
Crude and natural gas liquids produced		
— gross	112,000	115,000
— net	75,000	76,000
Crude oil processed by and for the Corporation	301,000	339,000
Petroleum products sold	269,000	286,000
	Thousands of cubic feet per day	
Natural gas produced and sold		
— gross	373,000	417,000
— net	271,000	302,000
	Pounds per day	
Petrochemical sales	2,855,000	2,542,000

Report to the shareholders

Since the enunciation in 1976 of Canada's energy strategy, government and industry have been working to achieve its goal of self-reliance. During 1978 several important events within the energy industry signalled an effective step for Canada towards increased security of supply.

Progress continued in the development and utilization of the vast reserves of the Alberta oil sands. Syncrude Canada Limited came on stream in August, 1978, and Great Canadian Oil Sands Limited announced expansion plans to increase significantly its productive capacity. These two oil sands operations alone are expected to account for ten per cent of the crude oil produced in Western Canada in 1979. Additional projects using existing and new technology could supply 50 per cent of oil demand by the year 2000, according to Gulf Canada forecasts. New undertakings are already in the proposal stage: another major oil sands mining venture in the Fort McMurray area and a heavy oil project at Cold Lake. These non-conventional oil sources will provide Canada's future energy needs and Gulf Canada intends to be an active participant in their development.

High activity levels continued for the third consecutive year in the exploration for crude oil and natural gas in the western provinces. Drilling activity showed major increases in completions and footage over gains made in 1977. Much of the action was concentrated in the West Pembina region of Alberta where exploration has only begun to penetrate the prospective deeper producing zones. Another promising exploration play is the Elmworth area which should result in the addition of substantial new natural gas reserves. As a major explorer, Gulf Canada continues to have a well-balanced program with good representation in the most prospective areas, including the frontiers. This strong position and a commitment to an aggressive exploration program should enable the Corporation to maintain its place as the second largest gas producer and third largest oil and gas liquids producer in Canada.

Uncertainty with respect to domestic oil price increases was removed at year-end with the announcement of a new federal-provincial agreement on oil and gas pricing. Over the past three to four years, as an element of the federal government's energy strategy, there has been a steady escalation in both oil and gas prices to induce conservation and the development of additional supplies. While there will be a six-month "pause" in the upward movement of energy prices in January, 1979 (in contrast to the Organization of Petroleum Exporting Countries' decision to raise world oil prices by 14.5 per cent in 1979), the long-term policy is for Canadian prices to move to world levels, but not to exceed U.S. prices at Chicago. The anticipation of a continued and stable upward price movement, along with continued legislative support to expedite heavy oil and oil sands plants, should ensure continued exploration and development activity and thus increased supplies.

During the year the industry had an opportunity to review the outlook for both oil and natural gas in hearings before the National Energy Board. Industry exploration successes, coupled with continued conservation efforts by energy consumers, have resulted in the build-up of significant volumes of shut-in oil and gas. The extra amount of oil that could be produced from wells in Western Canada is estimated at 500,000 barrels per day, while the excess supply of natural gas is placed at one billion cubic feet per day. Growth in the demand for petroleum products and natural gas — one and four per cent in 1978 respectively — has not been high enough to absorb these surpluses.

The NEB findings for oil supply and requirements reported in October reflected Canada's

brighter petroleum situation since the last hearing in 1976. On the basis of higher supply and lower demand estimates, the NEB recommended that current permitted export levels for crude oil be extended for the next three years and that the throughput of the Sarnia-Montreal pipeline be increased from 250,000 to 315,000 barrels a day. As for natural gas, the general view of the industry, as reflected in Gulf Canada's submission, was that new markets were needed for the growing surplus. The NEB's February, 1979, report on natural gas supply and requirements confirmed an improved outlook and indicated that sufficient supplies exist in Western Canada until 1992 to meet all demands, including some additional exports above those currently authorized. Later in 1979 the NEB will weigh the costs and benefits of an extended natural gas transmission system, as well as a number of proposals to export. There are indications that some solution to this imbalance between supply and demand for natural gas will be found during 1979 or early 1980.

In the refined products business, low growth in demand together with about 35 per cent surplus refining capacity resulted in the continuation of extremely depressed product prices in Eastern Canada. The last six months of the year saw some price firming as refiners reduced their crude throughput and inventories but, even with this improvement, prices generally remained below the levels approved by the Anti-Inflation Board. In order to utilize surplus capacity, industry — and Gulf in particular — has been working closely with governments in both Canada and the United States to develop export markets for refined products in the New England area. If successful, refiners will be in a position to utilize their excess capacity and improve their returns.

Lower earnings from refined products and chemicals, due to the severe market competition, offset improved natural resource earnings for Gulf Canada in 1978. As a result, consolidated net earnings amounted to $182.9 million or $4.02 per share, about one per cent lower than the $185 million or $4.07 per share earned in 1977.

Net revenues totalled $2,584 million, an increase of $227 million from the previous year. Details of financial and operating results appear later in this report.

Gulf Canada Resources Inc., a wholly-owned, Calgary-based subsidiary, began operations on January 1, 1979, assuming responsibility for the Corporation's resource activities.

President and Chief Executive Officer of the resource company is S. K. McWalter, formerly a Senior Vice-President of Gulf Canada. In October, 1978, Mr. McWalter had succeeded S. G. B. Pearson as a Senior Vice-President with executive responsibility for Exploration and Production following Mr. Pearson's retirement after 33 years of service. R. H. Carlyle and E. M. Lakusta, former Vice-Presidents of Gulf Canada, were appointed Senior Vice-Presidents of the new company. All three will serve on Gulf Canada Resources' five-man Board of Directors which also includes C. D. Shepard and J. L. Stoik. Approximately 1,070 Gulf Canada employees in the western provinces are employed with the resource company, which will be headquartered in the Gulf Canada Square building in Calgary when completed this fall.

Following shareholder approval at the Annual Meeting to be continued under the Canada Business Corporations Act and to raise the number of Directors from 12 to 14, J. C. Phillips, Q.C., and W. P. Wilder were elected to the Board. Shareholders also approved changing the name of the Corporation to Gulf Canada Limited and, in French, Gulf Canada Limitée.

During the year E. E. Walker was appointed a Vice-President with executive responsibility for Corporate Planning; and R. C. Beal, Vice-President of New Business Development and Chemicals, assumed executive responsibility for the Research and Development Department.

At a regular Board meeting on February 14, 1979, John D. Allan, President of the Steel Company of Canada, Limited, succeeded J. Peter Gordon as a Director following Mr. Gordon's resignation after election to the Board of Gulf Oil Corporation; and W. P. Wilder submitted his resignation as an Officer and Director to accept the presidency of The Consumers' Gas Company. Also at this meeting W. H. Burkhiser, Treasurer of Gulf Canada, was appointed a Vice-President; L.G. Dodd was appointed a Vice-President and Controller; and approval was given to reduce the number of Directors from 14 to 13.

Canada's movement toward energy self-reliance in 1978 was the result of increasing cooperation and understanding between government and industry. Gulf Canada remains committed to maintaining this spirit in 1979 and beyond in the belief that such an environment is vital for a healthy industry.

Once again we take this opportunity to acknowledge the outstanding teamwork of the men and women in our organization whose loyalty, dedication and ability enable us to look to the future with confidence.

On behalf of the Board,

Chairman of the Board.

President.

Toronto, Ontario, March 23, 1979.

Financial review

Earnings

Earnings for the year amounted to $182.9 million or $4.02 per share, compared with $185.0 million or $4.07 per share for 1977. Net revenues rose $227.2 million to $2,583.7 million, but the improvement was almost entirely offset by higher purchase costs and other expenses. Income and other taxes charged to income amounted to $242.0 million compared with $235.5 million in 1977. Total taxes and other payments to governments together with taxes collected from customers on their behalf are shown in Table I.

As shown below in the statement of earnings by major business segment, profits from Natural Resources increased due to higher prices for crude oil, natural gas and natural gas liquids. Earnings from the Refined Products and Chemicals operations declined due to severe market competition which prevented price increases authorized under the Anti-Inflation Program to cover higher costs and expenses from being fully realized.

Financial position

Working capital declined $56.0 million to $482.4 million at the end of 1978. While external long-term borrowings were much lower than in 1977, the funds generated from operations were not sufficient to cover capital expenditures of $369.8 million, details of which are shown in Table II, as well as debt repayments and dividends to shareholders. However, total capital and exploration expenditures decreased slightly to $485 million in 1978 from $493 million in 1977, and a planned reduction of some 13 million barrels of crude oil and refined product inventories lowered funds employed by

Financial Results by Major Business Segments

	Revenues		Net earnings after tax		Capital employed at December 31	
	1978	1977	1978	1977	1978	1977
	(millions of dollars)					
Natural resources	$ 619.1	$ 551.4	$149.9	$139.3	$ 813.5	$ 619.4
Refined products and chemicals	2,305.3	2,092.6	29.9	41.1	1,198.5	1,154.4
Investment and sundry income	27.9	31.0	16.6	16.3	110.3	131.4
Interest on long-term debt	—	—	(13.5)	(11.7)	N/A	N/A
Inter-segment transfers	(368.6)	(318.5)	—	—	N/A	N/A
	$2,583.7	$2,356.5	$182.9	$185.0	$2,122.3	$1,905.2

The above information by segment is shown as though each segment were a separate business activity and, therefore, inter-segment transfers of products are eliminated to reflect total Corporation revenues as reported in the statement of earnings.

The natural resources segment includes exploration, development and production activities related to crude oil, natural gas, natural gas liquids, oil sands and minerals. The refined products and chemicals segment includes the manufacture, distribution and sale of petroleum and chemical products, as well as the business of Gulf Canada's wholly-owned subsidiary, Superior Propane Limited

General administration and other common costs have been allocated to each of the segments on an appropriate and consistent basis and income taxes calculated in accordance with the legislation applicable to each. Interest on long-term debt has not been allocated to the business segments and is shown separately.

The components of capital employed are set out in the five-year financial summary on page 32.

about $92.0 million despite increased per unit costs. As a result cash and short-term investments declined only $20.9 million. Dividends declared during 1978 totalled $51.9 million, or $1.14 per share. Actual payments to shareholders were $1.12½ per share as the dividend for the last quarter is not paid until January 1 of the following year.

The 1978 earnings represent a rate of return of 9.8 per cent on average capital employed, compared with 11.4 per cent in 1977 and 11.9 per cent in 1976. These rates are calculated on the basis of current earnings of each year measured against capital employed, much of which has accumulated at historic costs over many years. It is obvious that earnings and rates of return must be improved if funds are to be available to finance replacement and expansion of facilities. This is particularly true in the case of companies charged with providing future sources of energy for Canada. Replacement of existing crude oil and natural gas reserves will involve extremely costly projects for the development of synthetic or heavy oil deposits and exploration and development work in remote frontier areas.

Accounting developments

As indicated in our 1977 Annual Report, the Financial Accounting Standards Board (FASB) in the United States had issued a statement which was intended to standardize accounting practices for the oil and gas exploration and production activities of the petroleum industry beginning in 1979. During 1978 the effective date of the FASB statement was deferred following the release of a series of regulations by the Securities and Exchange Commission (SEC) which permitted companies to practice a method of full cost accounting as an alternative to the successful efforts method proposed by the FASB. Gulf Canada believes it is appropriate to revise its practices in line with the successful efforts method proposed by the FASB.

The major changes will be the capitalization of development dry hole expenses, changes in the timing of the write-off of unsuccessful exploratory drilling, and changes in the methods of amortizing capitalized costs and in the method of providing impairment reserves for unproved properties.

These changes, which will be implemented effective January 1, 1979, are not expected to have a material effect on either retained earnings or net income.

The Canadian Institute of Chartered Accountants recently issued a recommendation regarding accounting for leases entered into after January 1, 1979. The recommendation would require that a lease which transfers substantially all of the benefits and risks incident to the ownership of property should be accounted for as the acquisition of an asset and the incurrence of an obligation by the lessee. The Corporation leases various assets and certain of these would qualify as capital leases. Such capitalization would have little effect on earnings and the increase in net assets and liabilities would not be material.

Table I — Taxes and Other Government Revenues

	1978	1977	1976
	(millions of dollars)		
From Gulf Canada			
Income taxes — current	$ 34.1	$ 46.5	$ 84.7
— deferred	68.1	64.2	37.6
Federal sales tax, property taxes, etc.	139.8	124.8	111.1
Petroleum and natural gas lease payments	44.0	46.4	18.2
*Crown royalties, less incentive credits	187.4	163.9	140.3
	$ 473.4	$ 445.8	$ 391.9
Collected for governments			
Gasoline, fuel, excise and export taxes	317.2	347.8	346.6
Grand total	$ 790.6	$ 793.6	$ 738.5

* Included in purchased crude oil, products and merchandise in the consolidated statement of earnings.

Table II — Expenditures on Property, Plant and Equipment

	1978	1977	1976
	(millions of dollars)		
Exploration and Production	$ 152.8	$ 121.0	$ 52.7
Syncrude project	82.3	102.6	97.4
Transportation	1.8	1.2	14.1
Refining	74.3	113.0	57.4
Petrochemicals	19.0	1.9	2.8
Marketing	28.8	34.2	31.8
Other	10.8	11.2	4.0
Total	$ 369.8	$ 385.1	$ 260.2

Natural resources

A record $350 million was invested by Gulf Canada during 1978 in the exploration for, and the production and development of petroleum resources, coal and minerals.

The Corporation's 16.75 per cent share of Syncrude costs for 1978 was $82 million. Exploration expenditures and natural resource capital expenditures, other than Syncrude, totalled $268 million, an increase of $39 million over 1977.

As shown in the financial review, 1978 after-tax earnings from natural resources were almost $150 million, $10 million higher than 1977, and accounted for 82 per cent of Gulf Canada's consolidated net earnings. The $10-million improvement reflected higher prices for crude oil and natural gas which more than offset the continuing decline in production volumes and higher operating costs.

Exploratory expenditures remained about the same as in 1977. Increased expenditures were incurred in non-conventional oil projects during 1978 to ensure improved results in future years.

Exploration

Land

The Corporation continued to upgrade the quality of its strong land position in 1978. At year-end Gulf Canada had a 27.1 million net acre interest in 104.2 million gross acres, up two million net acres from 1977.

This land is strategically located in Western Canada's conventional oil and gas areas, frontier regions, and in oil sands, coal and prospective mineral locations.

Near year-end a one-third interest in 500,000 acres of Saskatchewan crown land in the Lloydminster conventional heavy oil area was acquired. Under an agreement which requires expenditures by the three partners of up to $99 million, Gulf Canada will earn a one-third interest in 162,500 lease acres.

Western Canada

Exploration expenditures of $103 million in Western Canada repre-

Drilling in shallow Beaufort Sea is carried out from artificial islands like the one being prepared for the Issungnak well (left). On another man-made island, drilling at the Isserk E-27 location (right) probes into the Beaufort basin.

sented nearly 70 per cent of total exploration expenses. Of this total amount, $31 million was directed to drilling in Western Canada where 53 exploratory wells resulted in 12 gas discoveries.

Although wildcat drilling was widely spread through Western Canada, about 19 per cent of the expenditures went into foothills drilling where continued successes have added to gas reserves in the Robb-Hanlan and Stolberg areas of west-central Alberta.

Acreage Position as of December 31, 1978

	Gross	Net
	(millions of acres)	
Western Canada	8.8	5.4
Northwest Territories and Delta	6.1	3.1
Beaufort Sea	3.0	1.4
Arctic Islands	30.8	5.9
Atlantic	55.5	11.3
Total	104.2	27.1

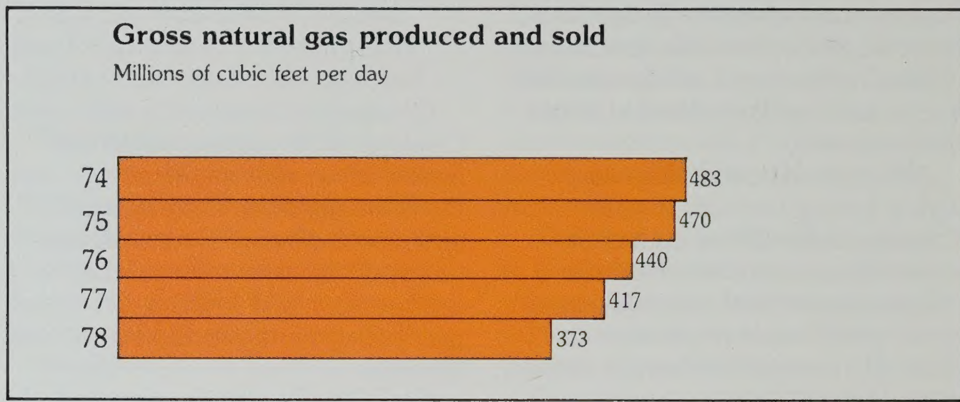
Of significant interest is the Coalspur 6-26 success which confirmed a four-mile extension of the Robb gas field. To the southeast, the Stolberg 6-5 success was an important delineation of the Stolberg gas field which is expected to go into production this year.

Gulf Canada also has a substantial acreage position in the British Columbia portion of the deep basin gas play, an area of considerable industry activity highlighted by the discovery of the Elmworth field in Alberta.

Near Magrath, in southern Alberta, a shallow farm-in well drilled by Gulf Canada resulted in a sweet gas discovery. By drilling the wildcat, the Corporation earned a 50 per cent interest in 18,000 acres.

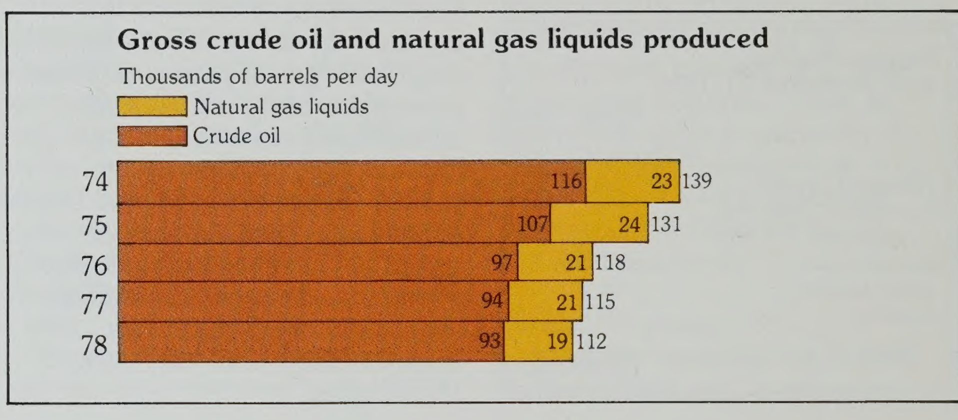
Frontier Exploration

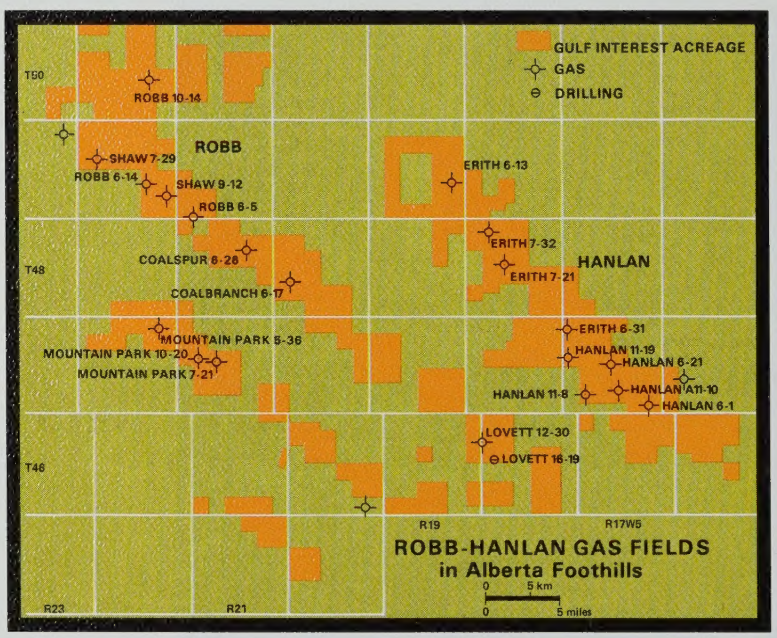
Frontier expenditures of $47 million, about 30 per cent of Gulf Canada's exploration outlay, provided participation in wildcat drilling in the Beaufort Sea, Arctic Islands and East Coast offshore. No work was conducted on the 75-per-cent-net-interest Mackenzie Delta acreage, where two trillion cubic feet of gas had been delineated by Gulf Canada prior to the federal government's decision against a Mackenzie Valley pipeline.



Beaufort Sea

In the Beaufort Sea where Gulf Canada's interest accounts for 1.4 million net acres in several blocks totalling 3.0 million gross acres, the Corporation participated in three wells from drillships during the short summer season. The Ukalerk and Kopanoar wells were drilled to total depth but, because of time restrictions, testing was held over until 1979. The third well, Tarsiut, will also be completed this summer.





In addition, construction of a drilling island was begun at the Issungnak location, six miles north of Isserk E-27 which previously had encountered a significant gas flow. Gulf Canada has a 29 per cent interest in both wells.

Arctic Islands
As a 25 per cent partner in the Arctic Islands Exploration Group, Gulf Canada participated in two wildcat wells, one of which was the Roche Point 0-43 gas success. Located off Melville's Sabine peninsula, 20 miles north of the Hecla gas field, the well flowed 20 million cubic feet of gas per day. Drilling from ice islands was underway at year-end at two additional wildcat locations — Desbarats, 35 miles northeast of Cameron Island, and Whitefish, 56 miles northeast of the Drake Point gas field.

East Coast Offshore
Exploration continued during the summer on the Labrador agreement blocks in which Gulf Canada has 16⅔ per cent interest in some 28 million acres. One well, Skolp, was drilled and abandoned, and a second, Roberval, was suspended for completion in 1979.

Natural Resource Capital and Exploration Spending

(millions of dollars)	1978		1977	
Exploration				
Western Canada	$103	69%	$108	71%
Frontiers	$ 47	31%	$ 44	29%
Total Exploration	$150	100%	$152	100%
Production				
Conventional	$ 59	30%	$ 41	23%
Non-Conventional				
Mineable oil sands (Syncrude)	$ 82	41%	$103	57%
In-situ oil sands	$ 11	6%	$ 36	20%
Coal-acquisition and development	$ 48	23%	—	—
Total non-conventional	$141	70%	$139	77%
Total Production	$200	100%	$180	100%
Total Resources	$350		$332	

Drilling activity	(gross wells) 1978	1977
Exploration	59	50
Development	116	123
Total	175	173

Production
Although Gulf Canada's production of crude oil, natural gas and gas products declined in 1978, price increases resulted in higher earnings.

Crude oil and natural gas production was limited by reduced industry demand. The gas supply surplus is expected to continue well into the 1980s. At present, approximately 20 per cent of Gulf Canada's production capacity is shut-in.

In a submission to the National Energy Board, the Corporation projected an optimistic supply picture for natural gas, recognizing the potential for continued increases in supply until the year

2000. As a partial solution to problems of surplus deliverability, Gulf Canada recommended trading off existing gas surpluses through exports to help finance the development of other domestic energy sources.

Production Operations and Reserves

Gross crude oil and natural gas liquids production declined from 115,000 to 112,000 barrels per day, while reserves decreased from 434 to 386 million barrels.

Efforts to arrest declining production in some producing oil fields included miscible flood recovery projects at South Swan Hills, Alberta, and Willmar, Saskatchewan. Both qualify for provincial government incentives.

Gross natural gas production dropped from 417 to 373 million cubic feet per day due to the oversupply situations which saw the Corporation's principal gas purchaser gain industry support to limit production voluntarily to 80 per cent of minimum contractual obligations, thereby sharing eastern markets more equitably among producers.

Gross natural gas reserves declined only slightly in 1978. Delineation drilling in the Robb and Hanlan areas of the northern foothills region of Alberta added 112 billion cubic feet of gas reserves, helping to almost offset 1978 production. Plans for a gas plant to serve these areas are being developed, with production expected to commence during 1983.

Gulf Canada drilled 116 gross development and infill wells, of which 41 were oil and 54 were gas successes. Major development drilling was undertaken in the Ricinus, Swan Hills, South Swan Hills, Wimborne and Hastings oil fields, while gas development programs were carried out in the Robb-Hanlan and the shallow Alberta plains fields.

To maintain gas deliverability, compression facilities were added at the Strachan, Brazeau and Ghost Pine gas plants. Installation of a major pipeline from the Stolberg field to the Ram River gas plant was well underway at year-end to bring on new gas reserves.

In December the Corporation awarded a contract for the construction of North America's first sulphur prilling facility to supply 1,000 tonnes per day of premium

Gross Crude and Natural Gas Liquids Production

	1978	1977
	(thousands of barrels per day)	
Major Fields		
South Swan Hills	23	22
Fenn Big Valley	15	13
Swan Hills	11	13
Redwater	5	6
Westerose	5	5
Other	34	35
Total	93	94
Natural gas liquids	19	21
Total production	112	115

Gross Natural Gas Sales

	1978	1977
	(millions of cubic feet per day)	
Major Fields		
Strachan	59	68
Westerose South	59	68
Nevis Unit	19	18
Gilby	17	20
Rimbey Unit	15	18
Other	216	239
Total	385	431
Less: from purchased raw gas	12	14
Produced and sold	373	417

quality product to overseas markets. To be built at the Strachan gas plant, it is expected to be on stream in late 1979.

New Energy Resources
The high levels of expenditures for coal acreage acquisitions and in-situ oil sands experimental programs, amounting to $59 million, confirmed a continuing emphasis in those areas other than conventional oil and gas exploration and development.

Mineable Oil Sands
The Syncrude oil sands project came on stream in August. Gulf Canada's 16.75 per cent interest in Syncrude represents the largest single investment in the Corporation's history. Start-up difficulties continued into 1979, but progressively higher levels of production are expected to be achieved throughout the year.

Gulf Canada is an eight per cent participant in the Alsands project. An application to construct and operate the plant has been submitted and is under consideration by the Alberta Energy Resources Conservation Board. Alsands, a mineable oil sands venture similar to

With each bite, a massive dragline at Syncrude lifts 80 cubic yards of oil sand from the Athabasca deposit for treatment in the newly-operating plant.

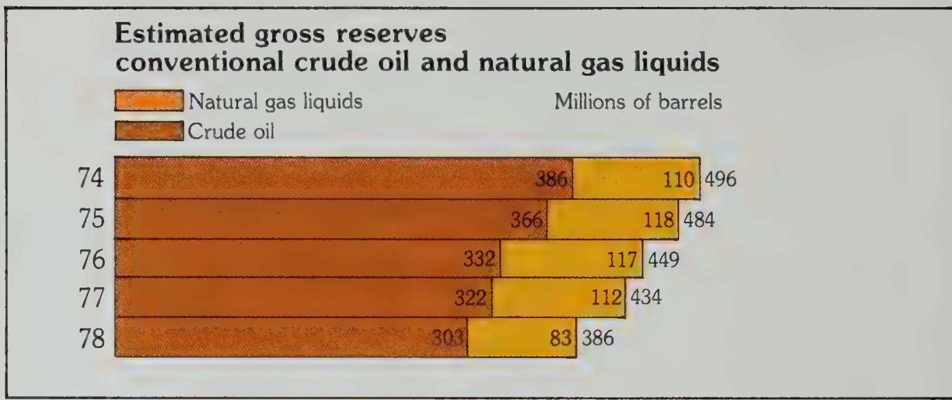
Dynamically-positioned drillship located on Gulf Canada interest acreage off Labrador.

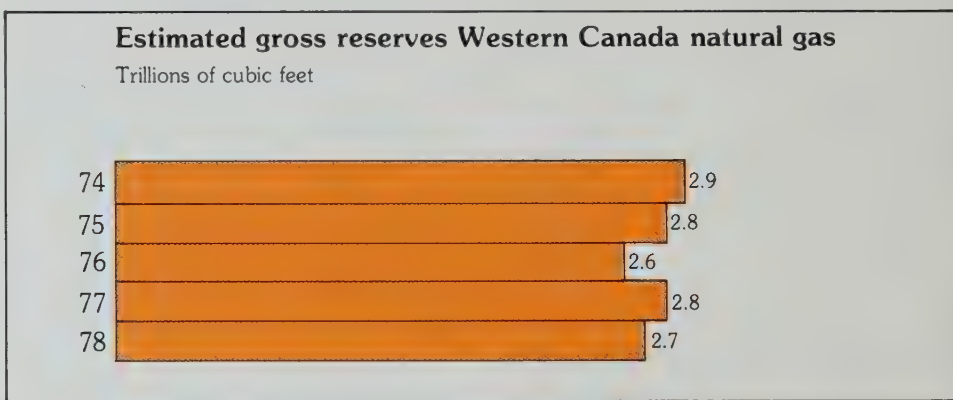
Syncrude, will have a capacity of 140,000 barrels per day of synthetic crude oil and is expected to be operating as early as 1986.

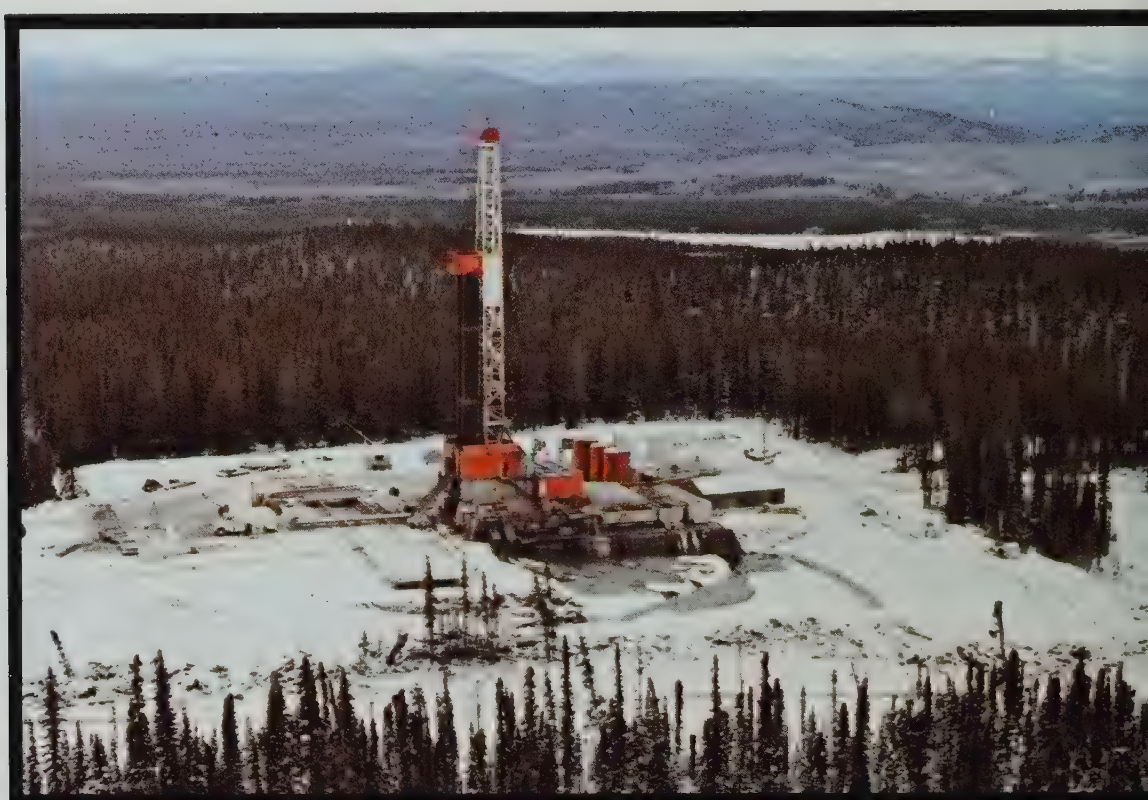
In-situ Oil Sands
Among Corporation-operated heavy oil pilot projects, the steam flood experiment at Cold Lake has yielded informative results, and a steam solvent injection experiment was in progress at year-end.

At the Wabasca site, a fire flooding test began in July and the results of the project's steam flood experiment are currently being evaluated.

In addition, engineering plans and feasibility studies are underway for a proposed in-situ pilot project on Gulf Canada's Surmont oil sands property in the Athabasca oil sands deposit.







The deep basin area of Alberta and British Columbia is a centre of considerable industry exploration activity. The Gulf Dome Norcen Thunder well, shown, was drilling at year-end.

Wellhead pumps at the Cold Lake pilot project draw bitumen from dee[p] underground deposits in steam injection experiment.

Coal and Minerals

The Corporation's first major coal exploration venture got underway with the acquisition of a 40 per cent interest in a 116,000-acre metallurgical coal property at Belcourt, in northeastern B.C. Gulf Canada also acquired 76,000 acres of coal property in the Chip Lake area west of Edmonton. An exploratory drilling program was conducted during the summer in the Mount Head area southwest of Calgary.

Gulf Canada continued to benefit from its 5.1 per cent interest in the Rabbit Lake uranium mine in Saskatchewan, and to share interests of up to 50 per cent in exploration activities undertaken through a joint venture with Gulf Minerals Canada Limited.

Estimated Recoverable Reserves

	Gross (1)		Net (2)	
	1978	1977	1978	1977
Proven Reserves Western Canada				
Crude oil and natural gas liquids (millions of barrels)	386	434	256	296
Natural gas (4) (trillions of cubic feet)	2.7	2.8	2.1	2.1
Other Reserves				
Syncrude (3) (millions of barrels)	190	191		
Sulphur (millions of long tons)	5.3	4.2	4.3	4.0

(1) Gross reserves are before deducting royalties. The reserve estimates include only those volumes considered to be proven and which appear with reasonable certainty to be recoverable in the future from known oil and gas reservoirs under existing economic and operating conditions.

(2) Government royalty rates can vary depending on prices, production volumes, the timing of initial production and changes in legislation. Net reserves have been calculated on the basis of the royalty rates experienced in late 1978.

(3) Synthetic crude oil reserves resulting from Gulf Canada's interest in the Syncrude Canada Ltd. project are shown in gross barrels only. The Alberta government's share from the Syncrude project is 50 per cent of net profits, as defined in an agreement between the project participants and the government, with an option to convert to a 7.5 per cent gross royalty. On either basis, the Alberta government has the right to take its share in kind. These reserves will be extracted by mining and processing tar sands.

(4) Natural gas reserves in the Mackenzie Delta are not included as their recovery depends on approval and construction of a pipeline to transport the gas to markets. Gulf Canada's share of gross reserves in the Parsons Lake area of the Mackenzie Delta is estimated to be approximately 1.3 trillion cubic feet.

Refined products and chemicals

Supply and distribution

In view of the larger volumes of Mexican crude oil being made available, a trial cargo was arranged for Montreal East refinery. The crude was found to be suitable and plans are being made to obtain regular supplies in 1979.

Members of the Organization of Petroleum Exporting Countries continued their crude oil price freeze through 1978. However, a political crisis in Iran removed about one-fifth of the OPEC supply from the world market and in the last quarter spot prices of crude rose to \$1.-\$2.00 per barrel above the official level. Because of contractual arrangements, Gulf Canada was not exposed to these premiums in 1978. However, since most of Gulf Canada's foreign crude supply has historically come from Iran, arrangements have been made for supplies from other sources. In December OPEC members decided on quarterly price increases during 1979 totalling 14.5 per cent.

As a result of federal government direction that Canadian crude should have preference over imports, throughput of the Sarnia-Montreal pipeline was increased from 250,000 to 315,000 barrels per day. Gulf Canada's allocated share of the line is being fully utilized. Increased use of Canadian crude at Montreal resulted in a corresponding one-third decline in the throughput of the Portland-Montreal pipeline.

Prices for Canadian crude were increased \$1.00 per barrel January 1 and July 1, 1978, as agreed by the federal and provincial governments.

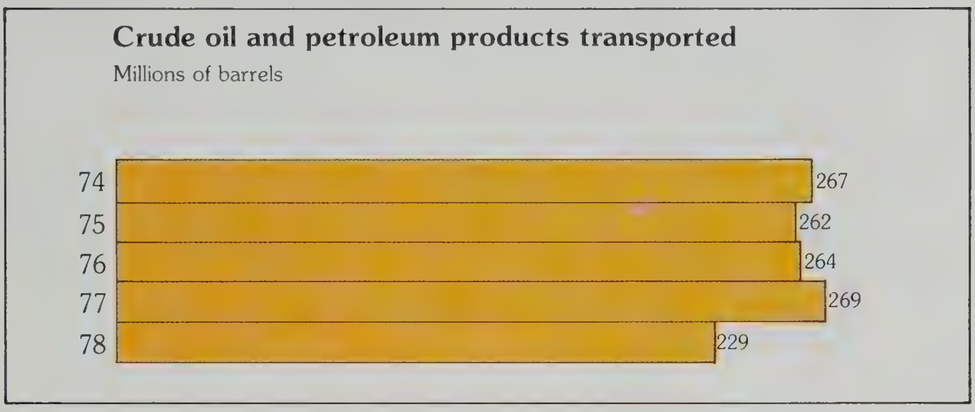
The Syncrude tar sands plant started delivering 40,000 barrels per day of crude in August, with test batches being processed at Edmonton, Montreal East and Port Moody refineries.

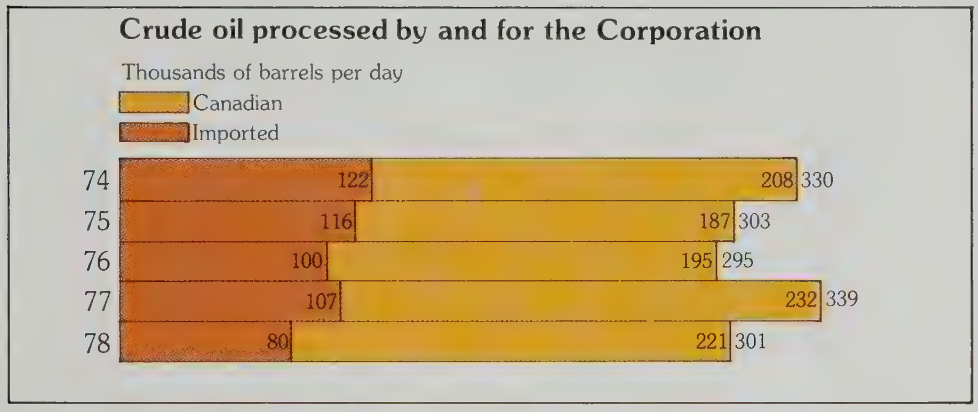
Refining

Crude oil processed amounted to 110 million barrels, down eleven

per cent from the 1977 record throughput of 124 million barrels. Lower product demands, particularly in Eastern Canada, together with inventory reductions, were responsible for significant decreases at Point Tupper, Montreal East and Clarkson refineries. Improved markets in British Columbia resulted in both Kamloops and Port Moody refineries exceeding last year's production levels.

Production commenced at the new $213-million lubricating oil plant at Clarkson refinery in early 1979. This is the largest investment in a wholly-owned facility ever made by the Corporation and is representative of the special type of investment opportunity Gulf Canada is pursuing to improve returns from refined products operations. Capable of quadrupling the refinery's previous lubricating oil output, the plant is designed to displace the approximately 25 per cent of Canada's requirements that were previously imported. During the year process unit control computer





Improved performance of Gulf Canada's three tankers, including the M/T Gulf Gatineau, *resulted in larger volumes being moved at reduced cost and use of outside charter vessels.*

Aerial view of Clarkson refinery where new lubricating oil plant is now in production.

projects were put into service at Edmonton and Port Moody refineries.

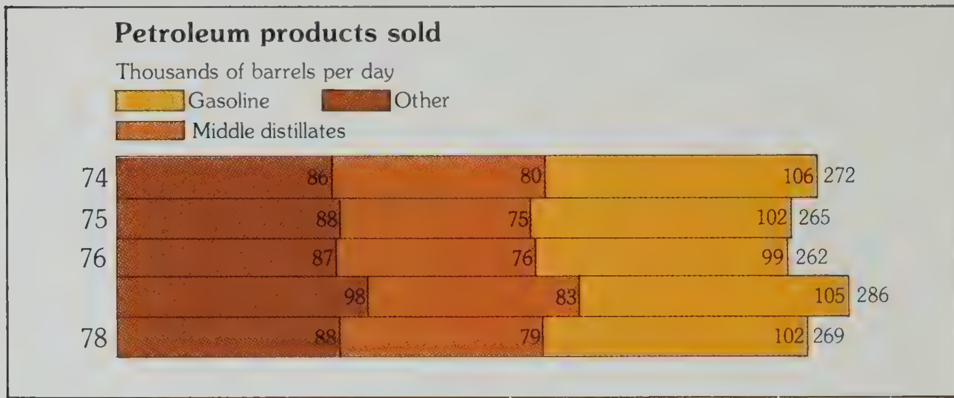
A maintenance productivity improvement program at all refineries will result in potential savings of about $15 million in the 1979-1983 period. In addition, a comprehensive energy-saving program will reflect substantial benefits over a similar period.

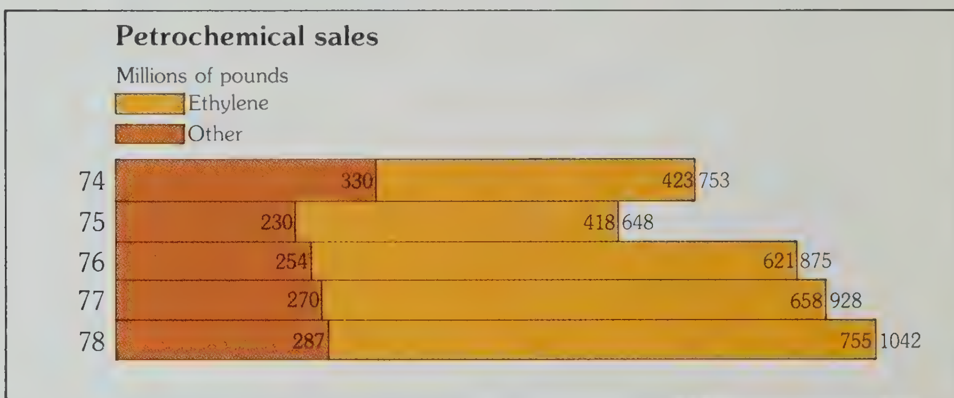
Marketing

Demand for petroleum products in Canada was essentially unchanged from the previous year, with moderate growth in transportation fuels being offset by lower sales of heating products. Consumer conservation continued to affect the level of consumption in all areas.

Gulf Canada's sales volumes were down over five per cent from 1977. Declines were significantly larger in Eastern Canada where surplus refining capacity has produced a keenly competitive market in which some selling prices barely cover the incremental costs of manufacture. Gulf Canada has opted to forego business not yielding a reasonable return, provided that the Corporation's long-term position in the refined products business is not jeopardized.

During the year about 600 service stations were closed as part of a program to phase out smaller





locations in favor of larger facilities, thereby not only reducing costs and ensuring a profitable operation for dealers but also providing better service to motorists. Since 1970 Gulf Canada's retail network has declined by nearly half to about 3,200 locations.

As a convenience to the growing number of "do-it-yourself" car owners who prefer to change their own motor oil, Gulf Canada introduced its lubricating oils through supermarkets and mass merchandising outlets in 1978. Seasonal service packages covering a variety of car maintenance programs at attractive prices continued to prove popular.

The petroleum industry's conversion period to metric measurement began on January 1, 1979. Extensive planning prior to that date enabled orderly conversion of the thousands of retail outlets and the millions of transactions involved. This year, as use of the metric measure increases, mutual understanding and patience by both the customer and Corporation will be required to adjust to the new measurement. Dealers and other personnel have been trained to assist customers in making the change.

Superior Propane increased both volumes and earnings in 1978.

The trend toward summer outdoor living combined with the popularity of recreational vehicles, heated swimming pools and gas barbeques attracted new users and helped correct the unbalanced winter-summer demand ratio.

With excess Canadian production available, propane is creating new fuel price relationships which should attract a larger share of the total energy market in the future.

Chemicals

Although sales volumes were relatively strong, earnings dropped 43 per cent below last year as a result of the inability to recover rising costs in the marketplace. Under-utilized world capacities were the main reasons for the declining margins. The price situation, particularly severe in the early part of the year, began to recover near the end of 1978.

The combined ethylene and propylene sales volumes were 14 per cent ahead of last year with the aromatics segment also showing improvement. In inorganic operations, calcium carbide production slipped to 95 per cent of last year. A modernization program at the Shawinigan Works carbide production facilities was started during 1978 and will be completed in 1979.

Effective December 31, 1978, Gulf Canada acquired the operation of Commercial Alcohols Limited at Varennes, Quebec. Commercial Alcohols produces and markets ethanol, which is derived from ethylene. The new acquisition will be operated as a wholly-owned subsidiary and managed independently of the existing Chemicals operations.

In conjunction with Union Carbide Canada Limited and the Quebec government, Gulf Canada is continuing to study the possibility of forming a consortium for the operation and ownership of current and future olefins facilities in the province of Quebec.

Closing of small retail outlets in favor of larger-volume self-serve locations, this one in Newfoundland, continues.

Installation of computers and electronic process controls, such as this new system at Port Moody, have reduced refinery operating costs and optimized yields.

Other activities

Research and development

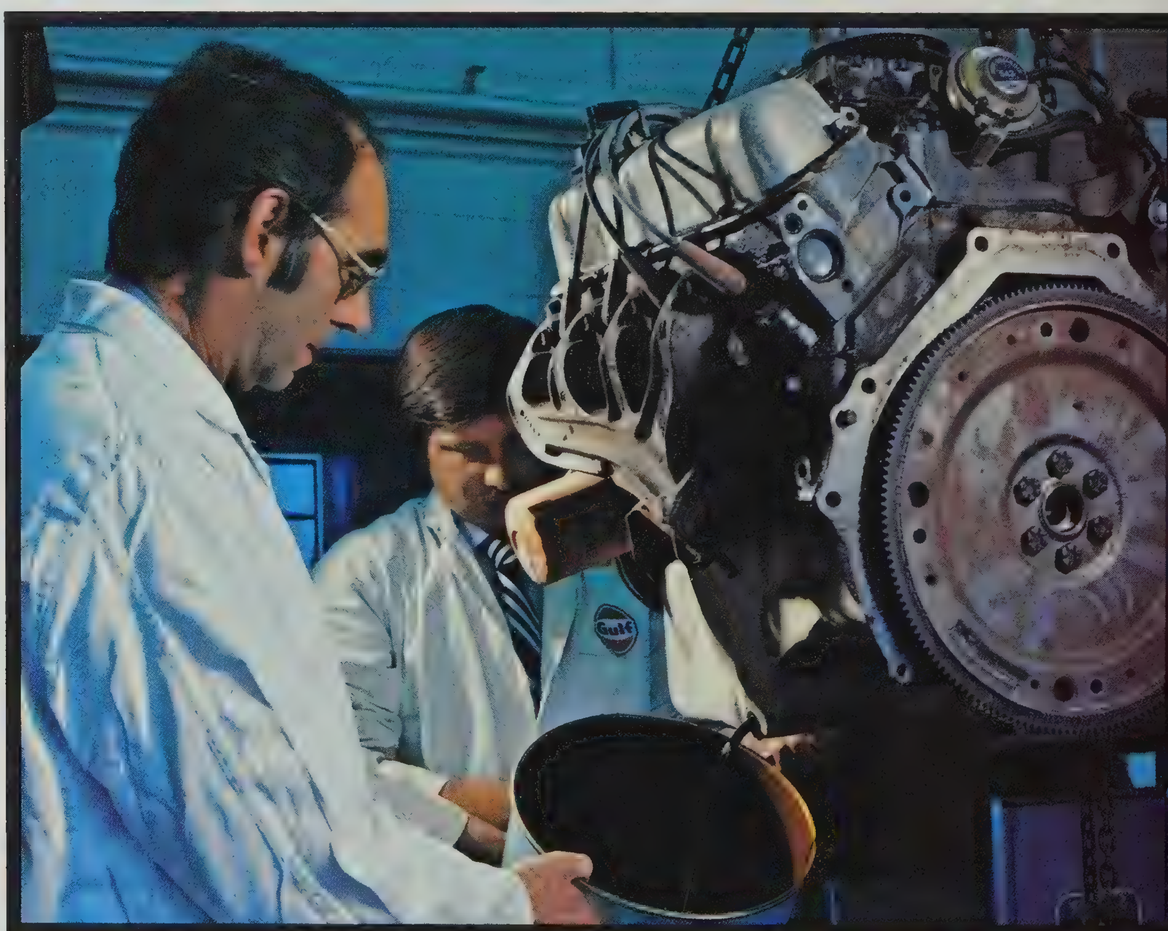
A full range of high quality automotive and industrial lubricants was formulated and tested prior to the start-up of Gulf Canada's new HydroTreating lubricating oil plant at Clarkson refinery. In addition, a semi-automatic X-ray spectrometer was developed to monitor product quality at the new lube plant.

R&D is investigating with the Production department techniques related to enhanced recovery from both conventional oil fields and heavy oil deposits. Also, in cooperation with the Refining department, alternate upgrading processes for heavy oil are currently being assessed.

Data supplied by Gulf Canada's computer-equipped mobile laboratory has enabled gas plants to make significant improvements in the recovery of propane.

The phasing down of lead in gasoline has attracted much interest in process technology for high-octane oxygenated gasoline components. Gulf Canada has developed this technology and patent applications for the process have been filed in a number of countries.

During the year sulphur-asphalt roads were built in Ontario, Louisiana and the Netherlands to further demonstrate the performance characteristics of Gulf Canada's unique process. An agreement was reached with the Research Institute of the University of Petroleum and Minerals in Saudi Arabia to make this technology available for highway pavements in that country.



Realty

Construction of the Gulf Canada Square building in Calgary continued on schedule. On November 30 a "topping off" ceremony of the 20-storey office tower signalled completion of the final cement pour and most of the building was enclosed at year end. Only 25 per cent of the space in the building remains to be leased. The complex is expected to be ready for occupancy by the Corporation's Calgary staff this September.

Human resources

Gulf Canada, jointly with Gulf Oil Corporation, provided on loan a total of 67 skilled employees to Syncrude Canada for start-up duties at the tar sands plant. By mid-1979 the majority of these employees will have returned to their home bases in Canada and the United States.

A one-year wage agreement providing for a six per cent increase was negotiated by all bargaining units in accordance with Anti-Inflation Board guidelines. The board rigidly applied its regulations by rejecting Gulf Canada's application for negotiated adjustments that exceeded six per cent, thereby creating further inequities within the petroleum industry. Salaried employees were also given a six per cent general increase.

On January 1, 1979, a dental plan was added to employee benefits. The plan, fully paid by the Corporation, covers regular active employees and dependents.

Ontario Premier William Davis opened new wing of Research and Development Centre at Sheridan Park.

Field testing of lubricating and transmission oils from new Clarkson facilities was conducted by research teams.

Public affairs

Gulf Canada, like most other companies, finds itself increasingly subjected to social issues, environmental considerations and government involvement in the performance of its business. The Corporation recognizes that its activities do have an impact on the Canadian public, acknowledges its social responsibility, and intends to continue to operate as a good corporate citizen.

During 1978 Gulf Canada continued communications with governments and other publics, drawing attention to surplus capacity problems in the industry; providing information on other issues including security of supply, pricing, dealer relations, environmental matters; and discussing possible solutions. A beginning was made in developing a process for early identification of significant issues and in assisting the operating management to understand and reflect social and political factors. The Corporation maintained its francization momentum in Quebec and received provisionary certificates well within the legal time frame.

In the interest of fostering better understanding between Canada's French and English-speaking cultures, Gulf Canada conducted an exchange program for children of employees in the summer of 1978. Forty youngsters

A continuing monitoring of air and water samples is carried out at Gulf Canada installations. Here, a water sample is collected.

Last summer 80 children of employees visited La Citadelle, Quebec City, as part of the Corporation's first cultural exchange program.

from the Montreal area spent two weeks with the families of 20 children in Toronto and 20 others in Calgary, who later paid return visits with the Quebec families. The Corporation also co-sponsored the translation and publication in French of the book "Must Canada Fail?," dealing with the national unity question.

To strengthen industry relations with the academic community, a Faculty Forum seminar was held at Banff where members of Gulf Canada's management held open discussions on subjects of mutual interest with faculty representatives from 12 Canadian universities.

Gulf Canada's corporate advertising on national television featured energy conservation within the Corporation, the search for new reserves, and technical expertise relative to research and the new lubricating oil plant at Clarkson. Several industry awards were won by the Corporation's publications and newsletters, which form an important part of Gulf Canada's internal communications program for employees, dealers and shareholders.

To provide a more co-ordinated approach to the development of corporate positions and responses to current and future public issues that could affect Gulf Canada, a re-organization of the Corporate Affairs and Public Relations departments into a new Public Affairs department was announced late in 1978.

Gulf Canada Limited

Consolidated statement of financial position

December 31, 1978

Assets

	1978	1977
	(millions of dollars)	
Current:		
Cash and term deposits	$ 19.4	$ 26.5
Marketable securities, at cost (approximates market value)	133.8	147.6
Accounts receivable	527.7	519.4
Inventories of crude oil, products and merchandise	400.7	483.3
Materials, supplies and prepaid expenses	39.0	30.0
Total current assets	1,120.6	1,206.8
Investments, long-term receivables and other assets:		
Investments in associated and other companies (note 3)	17.9	20.5
Long-term receivables, deferred charges and other assets	63.4	49.7
	81.3	70.2
Property, plant and equipment at cost less accumulated depreciation, depletion and amortization (note 4)	1,558.6	1,296.6
	$2,760.5	$2,573.6

(See accompanying notes to consolidated financial statements)

Auditors' Report

To the Shareholders of
Gulf Canada Limited:

We have examined the consolidated statement of financial position of Gulf Canada Limited as at December 31, 1978 and the consolidated statements of earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the corporation as at December 31, 1978 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Toronto, Canada,
February 2, 1979.

Clarkson, Gordon & Co.,
Chartered Accountants

Liabilities and shareholders' equity

	1978	1977
	(millions of dollars)	
Current:		
Short-term loans	$ 30.2	$ 25.6
Accounts payable and accrued liabilities (note 7)	491.1	534.6
Income and other taxes payable	69.4	67.1
Current portion of long-term liabilities	34.5	28.8
Dividends payable	13.0	12.3
Total current liabilities	638.2	668.4
Long-term liabilities (note 8)	350.1	332.7
Deferred income taxes	353.2	284.5
Shareholders' equity:		
Capital stock (note 9)	281.0	281.0
Retained earnings	1,138.0	1,007.0
Total shareholders' equity	1,419.0	1,288.0
	$2,760.5	$2,573.6

On behalf of the Board:

A. Powis, Director

C.D. Shepard, Director

Gulf Canada Limited

Consolidated statements of earnings

Year ended December 31, 1978

Earnings

	1978	1977
	(millions of dollars)	
Revenues:		
Gross sales and other operating revenues	$4,665.0	$4,235.2
Deduct —		
Crude oil sales (note 1)	(1,797.4)	(1,565.3)
Taxes collected for governments	(317.2)	(347.8)
Net sales and other operating revenues	2,550.4	2,322.1
Investment and sundry income	33.3	34.4
Net revenues	2,583.7	2,356.5
Expenses:		
Purchased crude oil, products and merchandise (note 1)	1,327.0	1,193.1
Operating expenses	266.0	227.5
Exploration, dry hole and other frontier area expenditures	115.2	107.9
Selling, general and administrative expenses	328.3	300.3
Depreciation, depletion and amortization (note 5)	96.3	85.8
Interest on long-term liabilities	26.0	21.4
	2,158.8	1,936.0
Earnings before income and other taxes	424.9	420.5
Taxes:		
Taxes other than taxes on income	139.8	124.8
Income taxes (includes deferred taxes of $68.1 in 1978; $64.2 in 1977) (note 2)	102.2	110.7
	242.0	235.5
Earnings for the year	$ 182.9	$ 185.0
Earnings per share	$ 4.02	$ 4.07

Retained earnings

	1978	1977
Balance, beginning of the year	$1,007.0	$ 871.2
Add earnings for the year	182.9	185.0
	1,189.9	1,056.2
Deduct dividends on common shares	51.9	49.2
Balance, end of the year	$1,138.0	$1,007.0

(See accompanying notes to consolidated financial statements)

Gulf Canada Limited

Consolidated statement of changes in financial position

Year ended December 31, 1978

	1978	1977
	(millions of dollars)	
Source of funds:		
From operations*	$349.8	$335.7
Sales of properties	17.6	15.7
Long-term obligations	33.9	180.6
Sales of investments	4.0	1.2
	405.3	533.2
Use of funds:		
Additions to property, plant and equipment	369.8	385.1
Reduction in long-term liabilities	37.3	30.6
Dividends	51.9	49.2
Other (net)	2.3	3.6
	461.3	468.5
(Decrease) increase in working capital	$(56.0)	$ 64.7
Working capital changes:		
Increase (decrease) in current assets —		
Cash and marketable securities	$(20.9)	$ 39.9
Accounts receivable	8.3	63.6
Inventories and materials	(73.6)	123.9
	(86.2)	227.4
Increase (decrease) in current liabilities —		
Accounts payable and other	(38.2)	126.1
Income and other taxes payable	2.3	16.3
Current portion of long-term liabilities	5.7	20.3
	(30.2)	162.7
(Decrease) increase in working capital	(56.0)	64.7
Working capital, beginning of the year	538.4	473.7
Working capital, end of the year	$482.4	$538.4

*Earnings for the year adjusted for charges or credits not affecting working capital.

(See accompanying notes to consolidated financial statements)

Gulf Canada Limited

Notes to consolidated financial statements

December 31, 1978

1. Accounting policies

The financial statements of the corporation have been prepared by management in accordance with generally accepted accounting principles consistently applied. Because a precise determination of many assets and liabilities is dependent upon future events, the preparation of periodic financial statements necessarily involves the use of numerous estimates and approximations. Such estimates and approximations have been made using careful judgment and in the light of information available up to February 2, 1979. These financial statements are, in management's opinion, correct within limits of materiality and within the framework of the accounting policies summarized below.

Principles of consolidation —
The accounts of the corporation and all subsidiary companies are included in the financial statements.

Investments in joint venture companies owned 50 per cent or less are accounted for on the equity basis.

Inventories —
Inventories of crude oil, products and merchandise are valued generally at the lower of cost applied on a "first-in, first-out" basis or market value determined on the basis of replacement cost or net realizable value.

Oil and gas properties —
The initial acquisition costs of oil and gas properties together with the costs of drilling and equipping successful wells (other than wells in remote frontier areas) are capitalized.

Exploration expenditures, including geological and geophysical costs, annual rentals on exploratory acreage and dry hole costs are charged to expense. All expenditures in remote frontier areas where future production is not reasonably assured, including the cost of discovery wells, are also charged to expense.

Depreciation, depletion and amortization —
Capitalized costs of oil and gas properties and drilling and equipping wells are charged against earnings on the unit-of-production method using estimated recoverable oil and gas reserves. Charges are made against earnings for depreciation of investment in plant and equipment based on the estimated remaining useful lives of the assets using either the straight-line or the unit-of-production method, whichever is appropriate. No charges are made against earnings for the capitalized costs of certain heavy oil and coal properties pending development.

Syncrude tar sand operations —
The corporation's share of all costs net of revenues received to December 31, 1978, has been capitalized and included with its share of the costs of the Syncrude plant and equipment. These capitalized preproduction costs will be amortized on a unit-of-production basis related to the corporation's share of the production and the estimated recoverable reserves beginning with the commencement of commercial production.

U.S. dollar liabilities —
Liabilities in U.S. dollars are translated to Canadian dollars at year-end rates of exchange. Gains or losses arising on translation of short-term liabilities are included in earnings. Unrealized gains or losses arising on translation of long-term liabilities are deferred and amortized over the remaining term of the liabilities.

Income taxes —
Income tax expense is computed on the basis of revenues and expenses reflected in the statement of earnings. A portion of such taxes is not currently payable as tax legislation permits the deduction of certain costs and allowances prior to the time they are recorded as expenses for financial statement purposes. The

amount not currently payable is included in the statement of financial position as deferred income taxes.

Investment tax credits are applied to reduce the cost of the related fixed assets.

Pensions —
Pension costs, which are determined by independent actuaries, are charged against earnings in the year premiums or funding requirements are payable. Prior service pension costs are being funded and charged to earnings over varying periods not exceeding fifteen years.

Crude oil transactions —
In addition to its own net production, the corporation purchases large volumes of crude oil from other producers and sells crude oil not required for its own refineries to other oil companies. It is the corporation's practice to offset such crude oil sales against crude oil purchases and thus exclude these transactions from both net revenues and costs.

Oil import compensation program —
Under the oil import compensation program the federal government compensates eligible importers with respect to petroleum imported for consumption in Canada, provided the importing company voluntarily maintains prices for products obtained from imported petroleum at the level suggested by the government. Compensation received or recoverable under this program is reflected as a reduction of the cost of purchased crude oil.

2. Income tax

Total income tax expense was $102.2 million in 1978 and $110.7 million in 1977 which represents an effective tax rate of 35.8 per cent and 37.5 per cent on earnings before income taxes for 1978 and 1977 respectively. The following schedule shows the main differences between the combined Federal and Provincial statutory tax rate and these effective rates:

	1978		1977	
	(millions of dollars)			
	Amount	%	Amount	%
Provision for income taxes at statutory rates	$137.4	48.2%	$141.9	48.0%
Add (deduct) the tax effect of:				
Inclusion in taxable income of crown royalties and other provincial payments	99.0	34.7	85.0	28.7
Resource allowance to partially offset inclusion of crown royalties	(73.8)	(25.9)	(63.1)	(21.4)
Depletion allowance earned by exploration and development expenditures	(36.5)	(12.8)	(33.3)	(11.3)
Frontier exploration allowance earned by frontier drilling expenditures	(10.6)	(3.7)	(9.4)	(3.0)
Inventory allowance to partially offset the effect of inflation	(7.0)	(2.5)	(5.1)	(1.7)
Other	(6.3)	(2.2)	(5.3)	(1.8)
Provision for income taxes reflected in the statement of earnings	$102.2	35.8%	$110.7	37.5%

3. Investment in associated and other companies

	1978	1977
	(millions of dollars)	
At cost:		
With quoted market value (based on closing prices at end of each year) 1978 — $34.9 million; 1977 — $35.4 million	$ 3.0	$ 3.9
Without quoted market value	.1	.1
	3.1	4.0
At equity:		
Investment in joint venture companies, at cost plus equity in undistributed earnings	14.8	16.5
	$17.9	$20.5

4. Property, plant and equipment

	Range of depreciation rates	Gross investment at cost (1)	Accumulated depreciation, depletion and amortization	Net investment 1978	Net investment 1977
		(millions of dollars)			
Exploration and production (2)	(3)	$ 843.7	$ 367.5	$ 476.2	$ 364.4
Syncrude project		360.2		360.2	278.0
Transportation	4% to 10%	55.7	24.9	30.8	31.5
Refining and petrochemicals	(4)	814.1	361.9	452.2	392.2
Marketing	2.5% to 10%	361.6	152.7	208.9	205.2
Other	2.5% to 10%	44.5	14.2	30.3	25.3
		$2,479.8	$ 921.2	$1,558.6	$1,296.6

(1) Additions during the year have been reduced by investment tax credits of $8.4 million ($10.2 million in 1977).

(2) Included in exploration and production assets are the initial acquisition costs of heavy oil and coal properties totalling $69 million at December 31, 1978.

(3) Unit of production.

(4) Processing units on unit of production, other items from 2.5% to 10%.

5. Depreciation, depletion and amortization

Depreciation, depletion and amortization in the statement of earnings consists of:

	1978	1977
	(millions of dollars)	
Depreciation of plant and equipment	$73.6	$66.4
Depletion and amortization of capitalized costs of oil and gas properties, drilling costs and other intangible assets	22.7	19.4
	$96.3	$85.8

6. Syncrude

The corporation is a 16.75 per cent participant in the $2.2 billion dollar Syncrude project, constructed and operated by Syncrude Canada Ltd., to produce synthetic crude oil from the Athabasca Oil Sands. Initial production began on August 1, 1978 but start-up problems continued to occur throughout the balance of the year. Costs during this period less revenues from the corporation's share of the production have been deferred as pre-production charges and included in property, plant and equipment.

The Alberta Energy Company Ltd. holds an option to acquire up to 20 per cent of the present participating interests in the Syncrude project. This option can be exercised up to six months after the start of production which is defined as the first of the month following production of 5 million barrels, which is expected to occur in the early months of 1979. Should the option be exercised to the maximum extent, Gulf Canada's 16.75 per cent interest would be reduced to 13.4 per cent with a proportionate recovery of its investment in the project.

Part of the corporation's interest in the project was financed through a $100 million convertible loan from the Government of Alberta. For a period of five years following the start of production, as defined, the Government of Alberta can convert all or part of the principal amount into an equity interest in the project based on the relationship of the amount converted to the total project costs. Should this option be exercised to the maximum extent, Gulf Canada's interest could be reduced by approximately 4.5 percentage points.

7. Accounts payable and accrued liabilities

Accounts payable and accrued liabilities include:

(1) Amounts owing to and from affiliated companies, all of which arose in the normal course of business, of $20.0 million and $4.2 million, respectively at December 31, 1978 ($152.4 million and $7.8 million, respectively at December 31, 1977).

(2) Payments of $12.5 million received during 1978 under 'take-or-pay' gas contracts. These amounts have been deferred and will be credited to revenue when the gas is delivered at the option of the purchaser.

8. Long-term liabilities

	Maturity	Amount (millions of dollars)
Debentures (1):		
$5\frac{3}{4}\%$, Series B	1982	$ 2.8
$5\frac{1}{4}\%$, Series C (2)	1982	7.8
$7\frac{3}{8}\%$, Series E	1988	31.5
$8\frac{1}{2}\%$	1989	3.7
$8\frac{1}{2}\%$	1990	3.1
$8\frac{3}{8}\%$ (2)	1997	148.2
$8\frac{1}{8}\%$ loan re Syncrude (3)		117.0
Interest-free loans (4)		27.3
Other long-term obligations	varying dates	43.2
		384.6
Less instalments due within one year included in current liabilities		34.5
		$350.1

(1) All debenture issues require sinking fund payments.

(2) Payable in U.S. dollars. Amounts outstanding in U.S. dollars:
$5\frac{1}{4}\%$ Series C 1982 $6.6 million
$8\frac{3}{8}\%$ Notes 1997 $125.0 million

(3) The Syncrude loan from the Government of Alberta is evidenced by an $8\frac{1}{8}\%$ Convertible Debenture which, as indicated in note 6, may be converted into a portion of the corporation's equity interest in the Syncrude project. In the event that the conversion option is not exercised, the loan is repayable in ten equal annual instalments commencing no earlier than 1984.

(4) These interest-free loans, originally borrowed under the terms of an agreement for exploration and development of certain properties, are repayable in 1979.

Approximate annual instalments of long-term debt due in the next five years are (millions of dollars): 1979 — $34.5; 1980 — $18.4; 1981 — $20.0; 1982 — $8.7; 1983 — $9.5

9. Capital stock

Shares without nominal or par value:

Authorized —
Upon continuation under the Canada Business Corporations Act the authorized shares of the corporation (which prior to continuance were 68,000,000 common shares without nominal or par value) became: Common — unlimited number without nominal or par value; Preferred — unlimited number without nominal or par value. The Preferred Shares shall rank in priority to the Common Shares and may be issued from time to time in series with the designation, rights, restrictions, conditions and limitations of each series in a manner as more particularly set out in the Articles of Continuance.

Issued —
Common — 45,497,406

The corporation's incentive stock option plan provides for the granting of options to purchase its common shares at the market price on the day when the options are granted. Under the plan, options become exercisable after one year's continuous employment immediately following the date the options are granted and are for a period of ten years. During 1978 no options were granted or exercised and at December 31, 1978, no options were outstanding.

10. Pension plans

The corporation has pension plans covering substantially all employees. The contributions by employees, together with those made by the corporation, are deposited with insurance companies and/or trustees according to the terms of the plans. Pensions at retirement are related to remuneration and years of service. The amounts charged to earnings (including amounts paid to government pension plans and amortization of prior service costs) were $19.9 million during 1978 and $13.9 million during 1977.

The plans were amended in 1978, with a further amendment effective January 1, 1979 to provide for increases in retirement benefits. The effective unfunded prior service pension costs at December 31, 1978, after giving effect to the 1979 amendments, were approximately $91.8 million of which approximately $74.0 million represents the excess of the actuarially computed value of vested benefits over the assets of the plans. These are currently being funded and charged to earnings over periods up to twelve years.

11. Commitments and contingent liabilities

The corporation has commitments in the ordinary course of business (for the acquisition or construction of properties and the purchase of materials and services) and contingent liabilities under various guarantees, all of which are not significant in relation to net assets.

Rentals under long-term leases for real property and other facilities approximate $20 million annually. Under certain of these long-term leases, the corporation has the option to purchase the leased assets and is obligated to make advances from time to time which will be applied against the purchase price if the option is exercised. It is estimated that such advances will aggregate approximately $20.9 million over the terms of the lease agreements (which expire in 1982) of which $13.8 million have been advanced to December 31, 1978 and of which $1.8 million will be payable in 1979.

12. Remuneration of directors and officers

The aggregate remuneration in 1978 of the corporation's fourteen directors as directors was $90,700. Five directors were also officers of the corporation during the same period. The aggregate remuneration during 1978 of the corporation's officers (including fourteen past officers) as officers was $2,393,903. No directors or officers of the corporation received any remuneration from a subsidiary of the corporation.

13. Anti-inflation program

Under the federal government's Anti-Inflation Act which was in force until December 31, 1978 the corporation was subject to mandatory compliance with legislation which controls prices, profit margins (excluding crude oil and natural gas operations which were controlled under the Petroleum Administration Act), employee compensation and shareholder dividends. Management is of the opinion that the corporation was in compliance with the requirements of the anti-inflation legislation.

14. Research and development costs

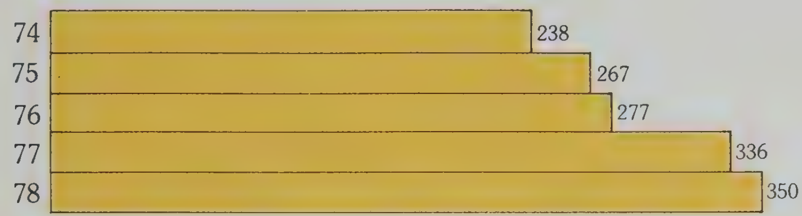
Research and development costs, which are charged to earnings as incurred, were $29.8 million for 1978 and $23.4 million for 1977.

Five year financial summary

Amounts, except for unit statistics, expressed in millions of dollars	1978	1977	1976	1975	1974
Balance Sheet					
Current assets	$1,120.6	$1,206.8	$ 979.4	$ 836.1	$ 825.2
Deduct: Current liabilities	638.2	668.4	505.7	396.2	467.5
Working capital	482.4	538.4	473.7	439.9	357.7
Property, plant and equipment — net	1558.6	1,296.6	1,008.7	830.3	746.1
Investments, long-term receivables and other assets	81.3	70.2	57.1	60.1	59.9
Capital employed	2,122.3	1,905.2	1,539.5	1,330.3	1,163.7
Deduct: Long-term debt	350.1	332.7	167.1	115.9	102.6
Deferred income taxes	353.2	284.5	220.3	182.7	162.8
Shareholders' equity	$1,419.0	$1,288.0	$1,152.1	$1,031.7	$ 898.3
Per share	$ 31.19	$ 28.31	$ 25.32	$ 22.68	$ 19.75
Capital Expenditures					
Property, plant and equipment	$ 369.8	$ 385.1	$ 260.2	$ 165.1	$ 115.9
Earnings					
Net revenues	$2,583.7	$2,356.5	$1,953.6	$1,729.9	$1,516.2
Deduct:					
Exploration and dry hole costs	115.2	107.9	63.2	53.9	48.9
Depreciation, depletion and amortization	96.3	85.8	73.2	71.0	70.4
Purchases and other expenses	1,947.3	1,742.3	1,417.9	1,186.6	1,030.5
	2,158.8	1,936.0	1,554.3	1,311.5	1,149.8
Earnings before taxes	424.9	420.5	399.3	418.4	366.4
Taxes:					
Taxes, other than income taxes	139.8	124.8	111.1	98.1	80.9
Income taxes	102.2	110.7	122.3	143.7	124.5
	242.0	235.5	233.4	241.8	205.4
Earnings for the year	$ 182.9	$ 185.0	$ 165.9	$ 176.6	$ 161.0
Rate of Return (per cent)					
On average capital employed	9.8	11.4	11.9	14.5	14.7
On average shareholders' equity	13.5	15.2	15.2	18.3	19.3
Funds from Operations	$ 349.8	$ 335.7	$ 277.3	$ 266.8	$ 237.8
Dividends Declared	$ 51.9	$ 49.2	$ 45.5	$ 43.2	$ 36.4
Per Share					
Earnings for the year	$ 4.02	$ 4.07	$ 3.65	$ 3.88	$ 3.54
Cash dividends	$ 1.14	$ 1.08	$ 1.00	$ .95	$ .80

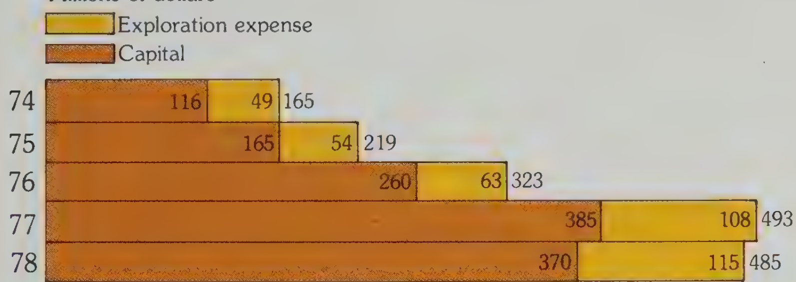
Funds from operations

Millions of dollars



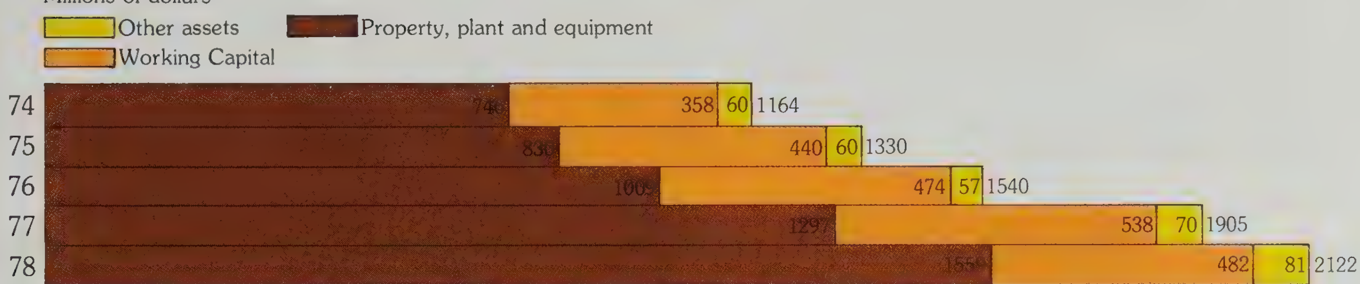
Capital and exploration expenditures

Millions of dollars



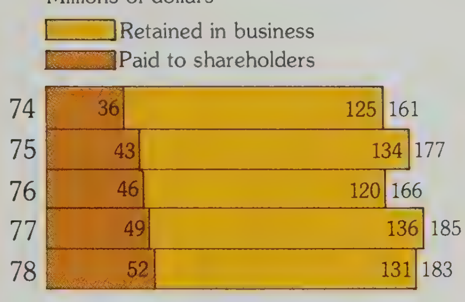
Capital employed

Millions of dollars



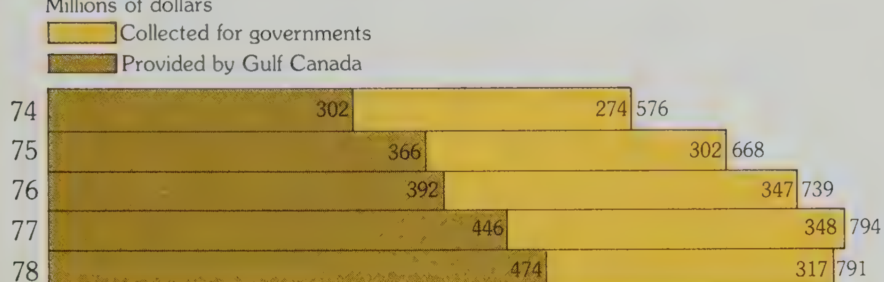
Net earnings

Millions of dollars



Taxes and other government revenues

Millions of dollars



Five year summary of operations

	1978	1977	1976	1975	1974
Crude and Natural Gas Liquids Produced *(thousands of barrels)*					
Gross	40,833	42,030	43,310	47,657	50,784
Net	27,258	27,841	29,546	33,125	36,210
Per day — gross	112	115	118	131	139
— net	75	76	81	91	99
Crude Oil Processed by and for the Corporation *(thousands of barrels)*					
Total	110,019	123,704	108,107	110,750	120,623
Per day	301	339	295	303	330
Petroleum Products Sold *(thousands of barrels)*					
Total	98,301	104,281	96,022	96,904	99,426
Per day	269	286	262	265	272

In addition to capital expenditures of $21 million for environmental conservation in 1978, Gulf Canada supported continuing "on the spot" training programs. At Point Tupper refinery (above) Corporation personnel participated in full-fledged government/industry exercises; crew members of the Gulf Mackenzie (right) carry out regularly scheduled oil spill simulation exercise at Clarkson refinery.

	1978	1977	1976	1975	1974
Natural Gas Produced and Sold					
(millions of cubic feet)					
Gross	136,270	152,063	161,071	171,603	176,473
Net	98,736	110,152	118,083	134,779	148,011
Per day — gross	373	417	440	470	483
— net	271	302	323	369	406
Petrochemical Sales					
(thousands of pounds)					
Total	1,042,211	927,769	875,322	647,624	752,827
Per day	2,855	2,542	2,392	1,774	2,063
Sulphur Sales					
(long tons)					
Total	310,879	343,999	254,525	202,741	272,985
Per day	852	942	695	556	748
Net Wells (Bore Holes) Capable of Producing at Year-End	1,546	1,499	1,437	1,400	1,400
Net Wells Drilled	89	108	59	45	37
Net Acreage under Lease, Reservation and Option (Hydrocarbons) *(thousands of acres)*	27,089	25,039	25,561	26,077	24,631

The Matter of Corporate Responsibility

The Board of Directors approved the following Statement of Business Principles which establishes ethical standards for the conduct of business by Gulf Canada.

I. Basic Business Principles of Gulf Canada

Gulf Canada adheres to the highest standards of ethics in the conduct of its business operations. Accordingly, the following specific principles represent the policy of the Corporation and are binding on all employees:

(i) In the conduct of its business operations Gulf Canada will comply with both the letter and the spirit of the laws of Canada or any other country in which the Corporation carries on business.

(ii) In addition to compliance with the law, the highest standards of integrity will be observed throughout the Corporation at all times.

(iii) The business of the Corporation will be conducted fairly and openly at all times.

II. Operating Principles of Gulf Canada

The basic principles of Gulf Canada will apply to all the operations of the Corporation. In the application of these principles, the Corporation will conduct its business with a sense of responsibility to its various constituencies, among them shareholders, employees, dealers, agents and distributors, customers, suppliers, governments and the community.

(i) *Shareholders*

In addition to its primary obligation to provide a fair return to shareholders, the Corporation will recognize a responsibility to conduct relations with them in an open and factual manner and in conformity with a policy of appropriate and timely disclosure.

(ii) *Employees*

Gulf Canada will continue to consider its employees as one of its greatest strengths. The Corporation will recognize as fundamental the obligation to encourage the development and well-being of its employees.

In its dealings with employees the Corporation will: ensure that employees and candidates for employment have equality of opportunity based on ability without regard for race, religion, national origin, sex, color or marital status; assist employees in improving and broadening job skills, encourage employee self-development and provide a work environment that is clean, safe, and that offers employees a sense of challenge and satisfaction; in recognition of the importance of employment stabilization, refrain from capricious hiring or firing practices; and communicate openly with employees on all aspects of Corporation policy and activity in which they have a legitimate interest.

(iii) *Dealers, Agents and Distributors*

Gulf Canada will continue to deal fairly and equitably with dealers, agents, distributors and others in similar positions by seeking to help them realize their aspirations for compensation, security and tenure while respecting their status as independent businessmen.

(iv) *Customers and Consumers*

Gulf Canada will continue to supply products of competitive quality at competitive prices supported by a level of service which will respond effectively to the needs of its customers. To meet and satisfy changing consumer demand, the Corporation will continue research programs to develop new and better products.

The Corporation will recognize the importance of energy conservation and will provide advice to customers in their efforts to utilize the Corporation's products efficiently.

Hand in hand with its commitment to conservation policies, the

Corporation will support government efforts aimed at securing adequate supplies of energy for all Canadians.

(v) *Suppliers*

Gulf Canada will purchase goods and services on the basis of cost, quality, reliability, and terms of delivery and service. On this basis, the Corporation will encourage purchases from Canadian manufacturers and will encourage the manufacture in Canada of materials essential to the Corporation's operations.

(vi) *The Community (Public)*

In addition to its responsibilities to shareholders, employees, customers and suppliers, Gulf Canada will recognize its responsibilties to the public at large.

Responsibilities will include: the conduct of Corporation business in an open, forthright and ethical manner in accordance with recognized norms in Canadian society; the assignment of a high priority to providing safe and clean facilities and services in all regions and communities of Canada where the Corporation operates; compliance with laws and regulations pertaining to the protection of the environment and the undertaking of additional efforts in instances where the Corporation considers further steps desirable and feasible; the encouragement of public awareness and understanding of the energy industry including problems associated with supply, demand, cost and environmental impact; the active participation in the resolution of public policy issues where the Corporation's expertise and experience will be useful; and the support of recognized educational, health, welfare and cultural objectives of the community.

(vii) *Governments*

Gulf Canada will continue to comply with all the laws and regulations of Canada and any country in which the Corporation carries on business.

In its relations with governments at the national, provincial and local levels, the Corporation will act in an open and forthright manner.

Gulf Canada will provide governments with information, advice and assistance where appropriate to help governments enact responsible policy and legislative measures in energy and related matters.

Gulf Canada will continue to stress its conviction that in any democratic society proper and constructive participation in the political process is a continuing responsibility of individuals and groups, including employees of the Corporation. Such participation must be in full accord with the regulations, laws and generally accepted practices of Canadian society.

The Corporation will not provide elected members or employees of any government department, agency, board or commission, directly or indirectly, with gifts, gratuities or anything of value through the use of corporate funds, services or facilities. Nothing in this paragraph prevents or prohibits employees of the Corporation from holding public office at the municipal or regional level when the duties of that office are part-time only and the discharge of which does not unreasonably interfere with the employee's ability to properly carry out the duties of his employment with the Corporation.

In any association with elected members or public servants, employees will continue to exercise careful judgment to avoid expenditures and other acts that might be perceived as improper or in violation of applicable laws.

Gulf Canada believes that it is socially responsible to support democratically constituted political organizations which support the concepts of the free enterprise system and that contributions to such organizations will help strengthen the political process in Canada. In accordance with Canadian laws, political contributions may be made from time to time to political parties, not to individuals or candidates for election, provided they are properly accounted for in the books of the Corporation and are within the aggregate annual amounts approved by the Board of Directors for such purposes.

III. Application

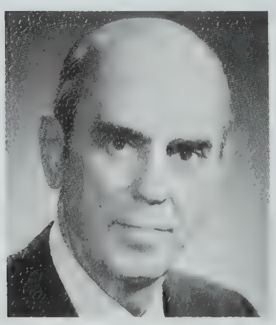
Strict compliance with the guidelines contained in the foregoing Business Principles is a condition of continued employment for all employees. Specific policies and procedures relating to a number of these principles are contained in the Corporate Policy Manual, of which this Statement forms a part. Observance of these principles includes the responsibility of each employee to seek interpretation in case of doubt about their application to a specific business situation and to report violations. Requests for interpretation and reports of violations should be made in writing, in the employee's discretion, to one of the following: the Chairman of the Board, the President, the Vice-President responsible for the department concerned, or the employee's immediate Supervisor.

The Chairman of the Board or the President shall be promptly notified of all requests for interpretation and reports of violations received by a Vice-President or a Supervisor, and the approval of either or both of them will be required for all decisions.

The Chairman of the Board will report to the Board of Directors from time to time on matters of major significance.

Directors

Kathleen M. Richardson
Director, James Richardson & Sons, Limited, Winnipeg, Manitoba. Director: Sun Life Assurance Company of Canada.



C.D. Shepard
Chairman of the Board and Chief Executive Officer, Gulf Canada Limited, Toronto, Ontario. Director: The Toronto-Dominion Bank.

J.L. Stoik
President and Chief Operating Officer, Gulf Canada Limited, Toronto, Ontario.

Alfred Powis
Chairman of the Board and President, Noranda Mines Limited, Toronto, Ontario. Director: British Columbia Forest Products Limited; Canadian Imperial Bank of Commerce; Placer Development Limited; Simpsons Limited; Sun Life Assurance Company of Canada.

***J. Peter Gordon**
Chairman and Chief Executive Officer, The Steel Company of Canada, Limited, Toronto, Ontario. Director: The International Nickel Company of Canada Limited; Bank of Montreal; Sun Life Assurance Company of Canada; Gulf Oil Corporation.
*Resigned February 14, 1979

E.F. Crease
Chairman, Alfred J. Bell & Grant Limited, Halifax, Nova Scotia. Director: Canada Permanent Trust Company.

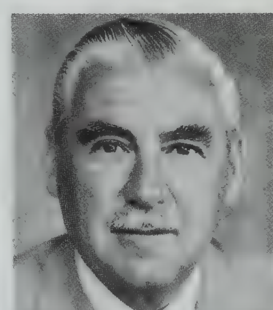
J.C. Phillips, Q.C.
Executive Vice-President, Gulf Canada Limited, Toronto, Ontario.

Gérard Plourde
Chairman and Chief Executive Officer, UAP Inc., Montreal, Quebec. Vice-President and Director: Alliance Compagnie Mutuelle d'assurance-vie; The Toronto-Dominion Bank. Director: Bell Canada; Editions du Renouveau Pedagogique Inc.; Northern Telecom Ltd.; The Molson Companies Limited; Rolland Paper Company Limited; Steinberg's Inc.

***W.P. Wilder**
Executive Vice-President, Gulf Canada Limited, Toronto, Ontario. Director: Canada Systems Group (EST) Limited.
*Resigned February 14, 1979

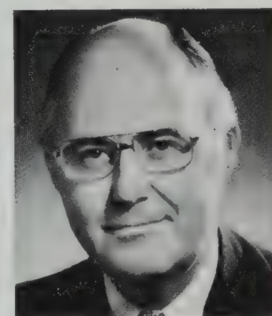
E.H. Crawford
President, The Canada Life Assurance Company, Toronto, Ontario. Director: Canadian Imperial Bank of Commerce; Moore Corporation Limited; Canadian Enterprise Development Corporation Limited.

L.P. Blaser
Executive Vice-President, Gulf Canada Limited, Toronto, Ontario. President: Alberta Products Pipe Line Ltd. Director: Interprovincial Pipe Line Limited; Trans Mountain Pipe Line Company Limited.



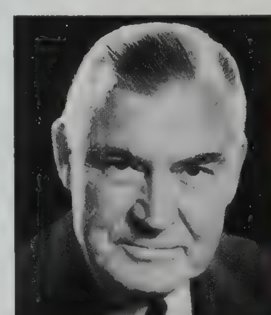
R.G. Rogers
Chairman of the Board and Chief Executive Officer, Crown Zellerbach Canada Limited, Vancouver, British Columbia. Director: Canadian Imperial Bank of Commerce; Genstar Limited; Hilton Canada Limited.

W.H. Young
President, The Hamilton Group Limited, Burlington, Ontario. Director: The Steel Company of Canada, Limited; Gore Mutual Insurance Company; National Trust Company Limited; Drummond, McCall & Co. Ltd.



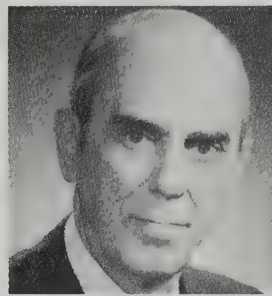
***J.D. Allan**
President, The Steel Company of Canada, Limited, Toronto, Ontario. Director: The Royal Trust Company; Royal Trustco Limited; Rockwell International of Canada, Ltd.
*Appointed February 14, 1979

D.S.R. Leighton
Director: Banff Centre, Banff, Alberta. Director: Canadian Appliance Manufacturing Co. Ltd.; GSW Limited; Lomex Mining Corporation; Rio Algom Limited; Standard Brands Limited; John Wiley and Sons Limited.



Beverley Matthews, Q.C.
Director Emeritus, Toronto, Ontario.

Officers



C.D. Shepard, Chairman of the Board and Chief Executive Officer.

J.L. Stoik, President and Chief Operating Officer.

L.P. Blaser, Executive Vice-President.

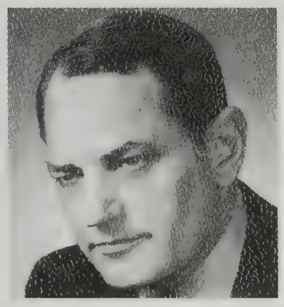
J.C. Phillips, Q.C., Executive Vice-President.

*__W.P. Wilder__, Executive Vice-President.
*Resigned February 19, 1979

**__S.K. McWalter__, Calgary, Senior Vice-President responsible for Exploration and Production.

R.C. Beal, Vice-President responsible for New Business Development, Chemicals and Research.

**__R.H. Carlyle__, Calgary, Vice-President responsible for exploration.



J.D. DeGrandis, Vice-President responsible for Supply and Distribution.

*__L.G. Dodd__, Vice-President and Controller.
*Effective March 1, 1979

W.H. Griffin, Vice-President responsible for Marketing.

R.E. Harris, Vice-President responsible for Human Resources and Realty.

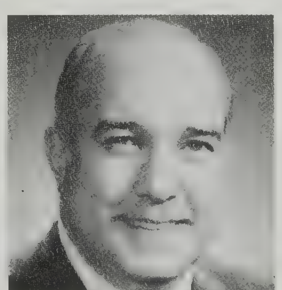
**__E.M. Lakusta__, Calgary, Vice-President responsible for Production.

K.C. Reeves, Vice-President responsible for Refining.

C.G. Walker, Vice-President responsible for Public Affairs.

E.E. Walker, Vice-President responsible for Corporate Planning.

W.M. Winterton, Vice-President General Counsel and Secretary.



*__W.H. Burkhiser__, Vice-President and Treasurer.
*Appointed Vice-President Effective March 1, 1979

*__J.A. Scobie__, Comptroller.
*Retiring April 1, 1979

**Resigned December 31, 1978.

Effective January 1, 1979, S.K. McWalter was appointed President and Chief Executive Officer of Gulf Canada Resources Inc.; R.H. Carlyle and E.M. Lakusta were appointed Senior Vice-Presidents of the new company.

Gulf Canada Limited

Officers

C. D. Shepard, Chairman of the Board and Chief Executive Officer
J. L. Stoik, President and Chief Operating Officer
L. P. Blaser, Executive Vice-President
J. C. Phillips, Q.C., Executive Vice-President
*W. P. Wilder, Executive Vice-President
*Resigned February 19, 1979
*S. K. McWalter, Senior Vice-President
*Resigned December 31, 1978
R. C. Beal, Vice-President
*W. H. Burkhiser, Vice-President and Treasurer
*Appointed Vice-President Effective March 1, 1979
*R. H. Carlyle, Vice-President
*Resigned December 31, 1978
J. D. DeGrandis, Vice-President
*L. G. Dodd, Vice-President and Controller
*Effective March 1, 1979
W. H. Griffin, Vice-President
R. E. Harris, Vice-President
*E. M. Lakusta, Vice-President
*Resigned December 31, 1978
K. C. Reeves, Vice-President
C. G. Walker, Vice-President
E. E. Walker, Vice-President
W. M. Winterton, Vice-President, General Counsel and Secretary
*J. A. Scobie, Comptroller
*Retiring April 1, 1979

Directors

*J. D. Allan, Toronto
L. P. Blaser, Toronto
E. H. Crawford, Toronto
E. F. Crease, Halifax
**J. Peter Gordon, Toronto
Dr. D. S. R. Leighton, Banff
J. C. Phillips, Q.C., Toronto
Gérard Plourde, Montreal
Alfred Powis, Toronto
Kathleen M. Richardson, Winnipeg
R. G. Rogers, Vancouver
C. D. Shepard, Toronto
J. L. Stoik, Toronto
**W. P. Wilder, Toronto
W. H. Young, Hamilton

*Appointed February 14, 1979
**Resigned February 14, 1979

Director Emeritus
Beverley Matthews, Q.C., Toronto

Head Office
800 Bay Street, Toronto, Ontario
M5S 1Y8

Marketing Region Offices
Montreal, Quebec; Toronto, Ontario; Calgary, Alberta

Chemicals
Plants: Montreal East, Shawinigan and Varennes, Quebec

Accounting and Data Processing Centres
Montreal, Quebec; Toronto, Ontario; Calgary, Alberta

Research and Development Centre
Sheridan Park, Ontario

Exploration/Production Offices
Calgary, Edmonton and Stettler, Alberta; Estevan, Saskatchewan

Operated gas plants: Bashaw West, Buffalo Lake North, Gilby, Morrin-Ghost Pine, Nevis, North Sibbald, Pincher Creek, Rimbey, Strachan and Swalwell, Alberta

Pipelines
Operated pipelines: Alberta Products, Gulf Alberta, Gulf Saskatchewan, Rimbey, Saskatoon, Shawinigan and Valley

Refineries
Point Tupper, Nova Scotia; Montreal East, Quebec; Clarkson, Ontario; Edmonton, Alberta; Kamloops and Port Moody, British Columbia

Asphalt Plants
Moose Jaw, Saskatchewan; Calgary, Alberta

Principal Affiliates (wholly-owned)

COMMERCIAL ALCOHOLS LIMITED
Head Office: Montreal, Quebec
President: W. A. Rogers

*GULF CANADA RESOURCES INC.
Head Office: Calgary, Alberta
President: S. K. McWalter

*Began operating January 1, 1979

SERVICO LIMITED
Head Office: Quebec, Quebec
President: W. H. Griffin

SUPERIOR PROPANE LIMITED
Head Office: Toronto, Ontario
President: R. G. Samworth

Registrar
Canada Permanent Trust Company, Toronto

Transfer Agents
Canada Permanent Trust Company — Vancouver, Calgary, Regina, Winnipeg, Toronto, Montreal, Saint John, New Brunswick; Charlottetown, Halifax, St. John's, Newfoundland

Registrar and Transfer Company — New York

Printed in Canada

Gulf Oil Canada Limited

Annual Meeting of Shareholders

April 27, 1978, Toronto, Canada

Remarks by:

C. D. Shepard, Chairman of the Board

J. L. Stoik, President

Annual General Meeting Proceedings

The 71st Annual General Meeting of Shareholders of Gulf Oil Canada Limited took place in Toronto on April 27, 1978. Of the total shares outstanding, 85.5 per cent were represented at the meeting either in person or by proxy. Clarence D. Shepard, Chairman of the Board and Chief Executive Officer, was Chairman. Also on the dais were John L. Stoik, President and Chief Operating Officer; L. P. Blaser, Executive Vice-President; W. M. Winterton, Vice-President, General Counsel and Secretary; and the following Directors: E. H. Crawford, Edward F. Crease, J. Peter Gordon, Gérard Plourde, Alfred Powis, Kathleen M. Richardson, Robert G. Rogers and William H. Young.

Following the business formalities relating to the assembly of the meeting, the financial reports of the Company were presented; the auditing firm of Clarkson, Gordon and Co. was re-appointed; and the existing Board of Directors was re-elected.

Subsequent to shareholder approval to raise the number of Directors from 12 to 14, J. C. Phillips, Q.C., and W. P. Wilder, both Executive Vice-Presidents of Gulf Canada, were elected to the Board.

Shareholders also approved changing the name of the Company to Gulf Canada Limited and, in French, Gulf Canada Limitée.

In his remarks, Mr. Shepard summarized his observations on national unity."The corporate management of Gulf Canada recognizes the legitimate aspirations of all Canadians to preserve their respective cultures, particularly the understandable desires of our 1,800 francophone employees in the Province of Quebec to work and prosper in their own language.

"I happen to hold the view that the objectives of the francophone can best be achieved within the Canadian confederation, perhaps modified, rather than through any form of sovereignty-association."

On the subject of the economy, Mr. Shepard said, "I recognize that some of our problems are deeply rooted and that the solutions are complex. But of this I am certain — today, as in the past, business organizations account for much of the character and activity of Canadian society as a whole. In particular, they form the foundation for creative

economic activity — the essential prerequisite of social progress.

"We must not minimize the seriousness of the problems of unemployment and inflation in Canada. The solution to these problems requires courage and initiative on our part. At the same time governments must provide Canadians with clear and strong leadership based on sound economic judgment, unaffected by possible short-term political gains."

Mr. Stoik reported that earnings of Gulf Canada for the first quarter of 1978 amounted to $41.8 million or 92 cents per share, a decrease of about five per cent from earnings in the same period last year, which have been restated at $43.9 million or 97 cents per share. Despite an increase in earnings from exploration and production, there was further price deterioration in the highly competitive refined products market, particularly in Eastern Canada, where there is excess capacity of about 30 per cent.

"The investment return on refining and marketing assets is becoming critically low," Mr. Stoik said, calling for a "badly needed rationalization of the industry in Eastern Canada." As a "logical and significant first step," he suggested a change in the Petrosar operation at Sarnia, which at present processes substantial daily volumes of crude in order to obtain the naphtha feedstocks it needs.

"We believe it would be a much better utilization of Canadian crude oil if Petrosar were to purchase its requirements from Ontario refineries with surplus capacity. Our estimate is that by this approach approximately one-third less Canadian crude oil would have to be processed to meet Petrosar's needs than at present. This would reduce the surplus light oils and residual fuels that Petrosar is releasing into the depressed Ontario market and would be a much more efficient use of a valuable resource," Mr. Stoik said.

Now that natural gas reserves have been discovered that will last well into the 1990's, Mr. Stoik suggested that Canada should be considering increased exports of natural gas to the U.S. "over limited periods of five to ten years" to provide continued incentive for exploration and to ease the balance of payments problem.

He said that Canada is more fortunate than most industrial nations since it has a number of energy

options which can be pursued in order to meet future energy requirements. "It is imperative that the industry and governments in Canada use the period afforded by our present adequate supplies to carefully assess the economic viability of the various energy alternatives available to us, so that priorities can be established for proceeding in a planned and orderly fashion."

The full text of the addresses by Messrs. Shepard and Stoik are included in this booklet.

Remarks by
C. D. Shepard, Chairman
and Chief Executive Officer,
Gulf Oil Canada Limited

Once again, I begin with a comment on the important question of dividends. This is always a matter of legitimate interest to our valued shareholders. Your Directors are sensitive to the adverse impact of inflation on shareholder expectations, particularly when coupled with the constraints on dividend increases imposed by the Anti-Inflation Board. As you are aware, we nevertheless have increased our dividend rate, to the extent permitted under Anti-Inflation Board rules, to the present level of 28½ cents per quarter. Let me assure you that this subject will remain under active consideration by your Directors.

Shortly, I shall be calling on John Stoik, your President and Chief Operating Officer, to speak about the Company's operating performance and outlook.

Key Issues

Before doing so, let me express some thoughts on two subjects of concern to all Canadians. One is the question of what must be done to rekindle the Canadian economy. The other is the related but still unresolved question of national unity.

There has been so much rhetoric on these subjects that the public must now be weary of introspection and jawboning. Nevertheless, corporations throughout Canada must not fail to address such key issues — by voicing views and, more importantly, by taking positive action. Each action by an organization may not of itself be great in size or scope, but if enough Canadians act, the total result is bound to be significant and impressive.

Insofar as the issue of the economy is concerned, I recognize that some of our problems are deeply rooted and that the solutions are complex. But of this I am certain — today, as in the past, business organizations account for much of the character and activity of Canadian society as a whole. In particular, they form the foundation for creative economic activity — the essential prerequisite of social progress.

We must not minimize the seriousness of the problems of unemployment and inflation in Canada. The solution to these problems requires courage and initiative on our part. At the same time, governments must provide Canadians with clear and strong leadership based on sound economic judgment, unaffected by possible short-term political gains.

Role of the Private Sector

It is encouraging to note growing recognition of the need to allow the private sector to do what it can do best to help restore our economy to greater health. We continue to believe that the performance of the private sector over past generations, in both good times and bad, though not perfect, has proven its worth and has earned it the right to continue to fulfill its traditional key role, hopefully with the deserved confidence of governments, labor, and the public at large.

Here again, corporate talk alone is not the answer. The private sector must not play a waiting game, excusing its self-doubt and postponement of programs — in effect, rationalizing its inactivity because of the uncertain outlook.

Perhaps the trouble today is that we hope too vaguely and dread too precisely. Mark Twain said, "There is no sadder sight than a young pessimist." Equally disturbing must it be for us to see Canada, a country that literally has everything, become a pessimistic young country. Constructive self-criticism, by all means, but not destructive loss of confidence!

Gulf Canada's Role

In terms of job maintenance and job creation, Gulf Canada has a creditable track record. I am confident this record will be continued as an essential part of our future performance; so long as we are permitted, after payment of all taxes and royalties, sufficient cash flow from both internally-generated and outside funds to ensure our capacity to do what our 10,000 Gulf Canada employees know best how to do.

And that is: to search for, find, produce and sell oil, natural gas, natural gas liquids and sulphur; develop synthetic and heavy oil; refine and transport by pipeline, ship, rail and road, chemicals and

petroleum products for sale; as well as sharing in the production of uranium and exploring for coal and other minerals.

That sort of action means responding continually, comprehensively and productively to the need of Canadians for our nation's energy resources.

The fact that our capital and exploratory spending as shown in our Annual Report far exceeds our profit is obvious proof that Gulf Canada is and must be action-oriented, and indeed must be an active contributor to the level of economic activity in the country. Almost all of the Company spending is reflected into someone's paycheque, which in turn becomes the real source of spending power fuelling the Canadian economy.

National Unity

On the question of national unity, I would first like to comment briefly in my imperfect Toronto French to our 3,400 shareholders, both present and absent, who claim Canada's other official language as their mother tongue.

La direction de Gulf Canada reconnaît le bien-fondé des aspirations de tous les Canadiens à la sauvegarde de leur culture respective et est particulièrement consciente des désirs légitimes de ses 1,800 employés francophones de la province de Québec qui souhaitent travailler et s'épanouir dans leur propre langue.

A mon avis les francophones peuvent beaucoup plus facilement atteindre leurs objectifs à l'intérieur d'une confédération canadienne — peut-être modifiée — qu'au sein d'une forme quelconque de souveraineté-association.

(Translation)

(The Corporate Management of Gulf Canada recognizes the legitimate aspirations of all Canadians to preserve their respective cultures, particularly the understandable desires of our 1,800 francophone employees in the Province of Quebec to work and prosper in their own language.

I happen to hold the view that the objectives of the francophone can best be achieved within the Canadian confederation, perhaps modified, rather than through any form of sovereignty-association.)

We can recall the words of Queen Elizabeth from Rideau Hall in Ottawa last year: "In a world divided by differences of color, race, language, religion and ideology the Canadian experience stands out as a message of hope. My prayer is that you will continue to offer this message to mankind."

The Queen was referring not only to French and English-speaking citizens. While what I have to say on this subject reflects the Quebec situation, it must not be viewed solely as a French-English issue.

Any widely held view, whether regional or ethnic, which adversely affects national unity, contributes to economic uncertainty and makes Canadians anxious about the future. But once again, progress toward the goal of unity starts with action.

For several years now, we in Gulf Canada have been working hard to make it clear to our 1,800 francophone and 500 anglophone employees in the Province of Quebec that there is room for all Canadians to feel at home in this great land, irrespective of ethnic origin, each of which enriches the other's; and that cultural background must not be allowed to be viewed as creating class distinctions.

Projects for Understanding

In addition to those past efforts, which are on-going, and include training in both official languages, we have recently acted in three specific ways. First, we have instituted a student exchange program to take place in July and August. By this plan, 40 young relatives of Gulf Canada employees in Quebec will visit for two weeks with children of Gulf employees in Toronto and Calgary, half in each city. At the end of two weeks, the visitors take their new friends home to Quebec for two weeks. The children, aged 11 to 13, win places in the exchange program following an essay contest — on "What Canada Means to Me."

Granted this is a small program, but if many companies do something similar — as indeed some already have, alongside Visites Interprovinciales and the exchange program of the Canadian Council of Christians and Jews — the total impact of such efforts will add a new dimension of thought in the minds of our young people and their parents. They will see first hand how much more we have going for us — and how much more promising is our

destiny — as an ongoing nation than if we allow ourselves to be fragmented.

The second specific action by your Company has been to arrange for the translation into French of a book entitled "Must Canada Fail?", to participate in translation costs and distribute both versions to employees and the public. The French edition will be available in December. In essence the book is a series of essays by 17 academics, mostly from Queen's University, all anglophone, some optimists, some pessimists, all dedicated to a peaceful democratic resolution of the conflicts. We commend its careful reading. Here is just one excerpt:

"Despite Canada's many failings, the political, social and economic institutions which have evolved in this country as the result of the presence of two cultures are worth preserving. Canada is a better country than it would have been if Quebec had not been a part of it; and it will be a less desirable country if Quebec removes itself . . . Despite the unquestionable penalties francophones have paid for being part of a predominantly English-speaking country, Quebec is also a better place today than it would have been had it not been a part of Canada."

The third specific action occurred last month in Banff when over a four-day period a dozen Gulf Canada management people, including two valued ladies, dialogued with a dozen academics, each selected by the president of a different Canadian university from disciplines from which we do not normally recruit new employees. This program was called "Faculty Forum." Subjects discussed were conservation and the environment, corporate behaviour, ethics and social responsibility, corporate profits, foreign ownership, energy supply and the free market, and national unity. It was an innovative and, as indicated by the letters and comments we have since received, a mutually rewarding meeting of minds to develop better understanding.

Confidence in Canada

Before I close I'd like to fix the corporate philosophy underlying these rather modest specific actions by quoting three eminent Canadians.

Former Conservative leader Robert Stanfield, contributing his views on national unity, said:

"Here we are living together, French-speaking and English-speaking Canadians, trying to preserve, conserve, nurture and develop a great land, trying to work together to fight poverty and hardship in our country, and from time to time when we can get our minds off ourselves, to do something to improve the rest of the world a little, and get the best out of two great languages and two great traditions."

To make it clear that in quoting Mr. Stanfield I am not declaring a political bias, let me quote from a 1964 speech by my long-time friend and fellow Manitoban, the Honorable Mitchell Sharp:

"Learning to be a Canadian not only involves learning to accept and to value diversity. It also means learning to communicate with those who belong to the other society and to share in common experiences and common enterprises, to live side by side anywhere in Canada."

For a third quotation, I'd like to include Harry Boyle, former CRTC chairman and a Canadian remarkably sensitive to the history and current state of Canadianism:

"There is a will to survive in Canada. It is based on the generosity of spirit and the interdependence that made it possible for our ancestors to conquer distance, loneliness and harshness of the environment. We have enjoyed a relatively peaceful country in a world of bitterness, war and injustice. For this good fortune, which transcends the observations and petty panics of the moment, I am convinced that most Canadians are prepared to work unselfishly. We owe it to our children — and to generations as yet unborn."

Finally, let me urge every shareholder of Gulf Canada to have confidence in the future of our great country. It has been said that we are all shareholders in Canada, which has become great by the brains and brawn, the hard work, ingenuity and enterprise of very many Canadians from many diverse ethnic origins. Together over the past 110 years we have caused Canada to grow and prosper. This performance, in which Gulf Canada has had a part for the past 72 years, must give us all confidence to participate in the future growth and strength of Canada, based on mutual respect for all cultures and all regions, each taking pride in his own and each other's contribution.

**Remarks by
J. L. Stoik, President
and Chief Operating Officer,
Gulf Oil Canada Limited**

Despite persistent problems in some areas, 1977 was a good year for both the oil industry and for Gulf Canada.

As you know from the Annual Report, which you have already received, net earnings increased by 12 per cent to $185 million or $4.07 per share, from $165.9 million or $3.65 per share in 1976. The 1977 earnings represent a return of 11.4 per cent on average capital employed, compared with 11.9 per cent in 1976.

As a move toward providing our shareholders and the public with more information on our operations, you will likely have noted that for the first time we showed a breakout of earnings by major segments of our business.

Before-tax earnings from Exploration and Production improved slightly, with revenue increases from higher crude oil and natural gas prices being largely offset by higher exploration expenses and lower production volumes. Earnings from our downstream operations, including Refining, Marketing and Supply and Distribution improved, due to better refinery utilization and somewhat higher sales volumes.

First-Quarter Earnings

I am now able to report to you that net earnings for the first quarter of 1978, amounting to $41.8 million or 92 cents per share, are down about five per cent from the earnings for the initial quarter last year, which have been restated at $43.9 million or 97 cents per share.

Despite an increase in earnings from our upstream operations, there was further price deterioration in the highly competitive refined products market, particularly in Eastern Canada, where there is considerable surplus refining capacity. Later I will comment on several government and industry options which could improve that situation.

Reinvestment

Reinvestment is a subject of interest to the federal government. Last year they introduced the Petroleum Corporations Monitoring Act to satisfy themselves and industry critics that petroleum companies in Canada, and the industry in general, are reinvesting within Canada a sufficiently large portion of their increased earnings in the quest for additional energy supplies.

In 1977 the Company's capital and exploratory expenditures in Canada amounted to $493 million. This was substantially higher than the $444 million in total cash generated by our operations before charging exploration expenses. This level of reinvestment, made possible by the increased cash flow and an increase in our long-term debt, was necessary to achieve the objectives we have established to ensure the long-term healthy growth of the Company. For 1978, capital and exploration expenditures are scheduled to be just over $500 million.

Over the past five years, including 1977, Gulf Canada's total capital and exploration expenditures amounted to well over 75 per cent of internally-generated cash. Recognizing that a company like Gulf Canada has substantial cash requirements for working capital, repayment of debt, and for dividends to shareholders, this is a very high level of reinvestment. In fact, the increased borrowing last year, which resulted in a significant change in the Company's debt/equity ratio, was required in order to allow us to sustain a maximum effort in the quest for new resources.

However, the massive and varied energy projects that are going to be necessary to meet Canada's future energy needs will require tremendous amounts of capital. Gulf Canada is demonstrating that we have accepted our responsibility to do our fair share in helping to find and develop future energy supplies for Canada.

Corporate Planning

In our corporate planning we have recently extended our horizons to the year 2000; and what we have concluded is both reassuring and very challenging in terms of our basic petroleum business.

Assuming that Canadian industries and individual Canadians are successful in biting the bullet on

serious energy conservation measures — and there are indications that a significant start has been made in this area — Canada's total energy requirements will still almost double by the end of the century.

Furthermore, indications are that crude oil and natural gas, which together provide over three-quarters of Canada's current energy requirements, will still be called upon to supply more than two-thirds of the much larger energy demands of the year 2000.

In short, well into the next century there will be a major requirement for the goods and services we provide. Somebody is going to have to be refining and marketing petroleum products for Canadians, and we feel we do those things as well as anyone. Gulf Canada's refining capacity across the country was largely modernized before the latest round of high-cost capacity additions by the industry, which puts us in a good competitive position. Furthermore, our new $210-million lubricating oil plant at Clarkson, scheduled to be in full operation this November, will make us a major factor in this important segment of the market.

So, despite the present depressed downstream profits and all the problems and difficulties we will have to face before the situation improves, your Company's management has made the long-term decision to continue as a strong participant in the refined products market, where we currently account for more than 15 per cent of the total business.

Broadening the Resource Base

Having said that, the primary thrust of our long-term decision to grow as an energy, petrochemical and minerals company in Canada is to broaden our resource base, to ensure that we will have the reserves necessary for the sound and profitable growth of the Company in the future.

In terms of oil and gas exploration acreage we have assembled not the largest acreage position in Canada, but one of the largest, which we believe provides about the best-balanced representation of any company in all of the most prospective exploration areas. These include the Beaufort Sea, Arctic Islands, Mackenzie Delta and the rest of the Northwest Territories on the mainland, off the

coast of Labrador and, of course, in Western Canada which has seen record activity during the past two years.

In recent months we have been successful in obtaining nine parcels of land in the West Pembina area, where significant oil discoveries by others have stimulated industry activity. Although our initial well on this acreage was unsuccessful, we have another nearing the target depth and are seeking to increase our representation in this promising area.

Syncrude

As you know, Gulf Canada's production of crude oil and natural gas liquids has been declining for the past seven years, because of the lack of major discoveries of conventional oil. Therefore we look forward to the start of production of synthetic oil from the Syncrude plant.

The first processing train, which will have a capacity of about 52,000 barrels a day, is scheduled to start up in June. Gulf Canada's 16.75 per cent share of the initial production will be about 8,000 barrels a day. This, along with about 3,000 barrels a day purchased from one of the other participants, will be processed at our Montreal East refinery.

The second Syncrude train now is expected to start up this fall, well ahead of schedule, raising production to about 108,000 barrels a day. Process refinements or "debottlenecking" will boost production close to 130,000 barrels a day by 1980.

Gulf Canada is considering participation in further oil sands projects, including a proposal to expand the capacity of Syncrude by an additional 50 per cent.

Surmont Acreage

Late last year your Company greatly increased its holdings in the Athabasca tar sands by acquiring a 100 per cent working interest in 119,000 acres of heavy oil lands held by Numac Oil and Gas Ltd. in the Surmont area of Alberta, some 40 miles south of Fort McMurray.

The average thickness of the uniform petroleum deposit which underlies this property is 75 feet.

Numac has drilled close to two dozen wells to evaluate this acreage, which is estimated to contain 14 to 16 billion barrels of oil. However, only a small portion of this amount will actually be recoverable.

In addition, Gulf Canada has in progress two heavy oil recovery pilot projects on our properties at Cold Lake and Wabasca, Alberta. The farm-in on the Numac acreage gives our Company a strategic position in one of Canada's most important long-term energy reserves.

Heavy Oil Upgrading

Incentives provided in the recent federal budget for enhanced oil recovery projects are a step in the right direction. The decision to treat heavy oil upgrading plants as manufacturing facilities eligible for accelerated write-offs and a reduced tax rate will also be beneficial. However, more incentives will be needed to make investment in heavy oil projects attractive. Hopefully, these would include allowing depletion to be earned on all of the plant investments, as in oil sands projects; and the producing provinces making the upgrading costs deductible from provincial royalties as Alberta does for gas processing.

Coal

Another major energy resource which is forecast to grow rapidly in importance between now and the end of the century is, of course, coal.

Until recently our Company was under-represented in this important area, with only a small exploration partnership with Rimrock Mining Corp. on a block of approximately 5,000 acres near Longview, Alberta, about 50 miles southwest of Calgary.

However, earlier this month we announced a significant joint venture agreement with Denison Mines Limited covering a feasibility study and ultimate development of the Belcourt metallurgical coal property located in northeastern B.C., about 65 miles south of Dawson Creek.

A full-scale exploration and feasibility study will get under way immediately at a cost of 10 to 15 million dollars. Work will begin on an initial area of 13,000 acres, which preliminary work indicates could support a production level of at least four million metric tonnes a year of high quality

metallurgical coal. It is expected that additional licenses will greatly expand the property under evaluation.

The interests in this joint venture will be Gulf Canada 40 per cent and Denison Mines 60 per cent. Denison will manage the exploration and feasibility study program and will be the initial manager of development. The first phase of the project will provide immediate employment for approximately 125 people. This agreement is subject to approval from the Foreign Investment Review Agency.

Uranium and Other Minerals

The total amount of energy produced by nuclear power in Canada is expected to be almost eight times the present level by the end of this century, assuring a growing demand for uranium.

Gulf Canada's 1977 earnings benefited for the first time from our five per cent share of production from the Rabbit Lake mine and mill in Saskatchewan, which is operated by Gulf Minerals Canada Limited.

In March of this year, Gulf Minerals announced that they are evaluating an ore-grade uranium deposit about a mile southeast of their previously-disclosed Collins Bay deposit, and some six miles northeast of the Rabbit Lake operation.

Over 220 drill-holes to date have intersected the ore body over a length of 2,800 feet and ranging in width from 150 to 400 feet. Analysis of the rock samples is continuing. If the deposit is large enough and rich enough to warrant production, the proximity of these reserves to the Rabbit Lake plant should improve their economic viability.

Gulf Canada's interest in this deposit is ten per cent, since that is our share of Gulf Minerals' northern Saskatchewan activities outside of the original Rabbit Lake development area. In the southern part of Saskatchewan and the rest of Canada we are participating with them on a 50-50 basis as part of our effort to expand Gulf Canada's resource base in uranium and other minerals.

Energy Problems and Solutions

The remainder of my remarks will be devoted to an assessment of Canada's present and future energy outlook.

Since it was only a few years ago that the industry was forecasting serious shortages of oil and natural gas in this country by the mid-1980's, you may well wonder how it can be that the industry now is faced with a gas surplus that could easily see us into the 1990's. Even harder to believe may be the fact that there is at present substantial shut-in crude oil producing capacity in Western Canada.

The fact is that since the earlier predictions were made a great many circumstances have changed, which could not have been accurately forecast even a year or two ago.

Let's think for a moment what those changes have been.

First of all, increased prices for oil and gas, following the international energy crisis, fostered conservation by energy consumers which along with the slowdown in the economy resulted in a very significant drop in the demand growth. At the same time, the higher prices resulted in much higher cash generation and greatly increased the incentive for companies to accelerate their exploration programs — and the industry has responded in just that way. Exploration activities in the conventional areas of Western Canada are at the highest levels ever. The result has been the discovery of substantial new reserves of natural gas and, more recently, there are indications of finds of significant volumes of oil, particularly in the West Pembina area.

Secondly, in addition to the effects of higher prices, exports of oil have been sharply reduced and are scheduled to be phased out by 1982. Partially offsetting the export reductions has been the movement of some 250,000 barrels per day of Western Canadian crude oil to Montreal. The net result, however, has been an increasing adverse balance of payments in petroleum trade.

There is a third factor that also needs to be considered — and that is the surplus refining capacity in Eastern Canada that was built over a period of years in anticipation of markets in the U.S. northeast, which unfortunately were lost due to changes in U.S. regulations. At the present time there is about 30 per cent over-capacity in the eastern provinces, resulting in severe price competition and residual fuel oil almost always selling for less than the price of crude oil. As a consequence, the rate of return on downstream assets is becoming

critically low. Since there is a shortage of refining capacity in the northeastern U.S., one move that would address both the Canadian refining surplus and the gas substitution problem would be for the Canadian government to negotiate access to U.S. markets for the surplus capacity.

With reference to the oil producing situation, I think everyone knows that with prorationing excess producibility has always been a fact of life. However, what is of concern today is the apparent size of the excess and the future uncertainty — particularly with regard to the possible effect on conventional production of the Syncrude volumes coming on stream.

The recent announcement by the federal government to allow increased volumes of crude from Western Canada to move to Montreal would seem to us to be a positive step. While the increased volume of approximately 70,000 barrels per day will not solve the excess producibility problem it is a step in the right direction. It will mean efficient use of the existing oil transportation facilities, it is a step towards improved self-reliance and security of supply, and it will assist in improving Canada's balance of payments by reducing imported oil by an equivalent amount.

Since the oil transportation system will soon be fully utilized, it would seem that there is a strong argument to use the oil flowing through the line in the most efficient way.

For example, the Petrosar plant at Sarnia is currently processing substantial daily volumes of crude oil in order to obtain the naphtha feedstocks it needs. We believe it would be a much better utilization of Canadian crude oil if Petrosar were to purchase its requirements from Ontario refineries with surplus capacity. Our estimate is that by this approach approximately one-third less Canadian crude oil would have to be processed to meet Petrosar's needs than at present. This would reduce the surplus light oils and residual fuels that Petrosar is releasing into the depressed Ontario market and would be a much more efficient use of a valuable resource.

We believe this kind of an approach could be a logical and significant first step towards a badly-needed rationalization of the industry in Eastern Canada.

Turning now to the gas situation, exploration results over the past ten years would indicate that Canada is gas-prone. The federal government is seeking to stimulate the substitution of natural gas for imported oil in Eastern Canada. This of course would help to reduce the massive balance of payments problems that lie ahead and would promote security of supply and energy self-reliance. One of the main obstacles, though, is the surplus of refining capacity which I have already discussed.

There is, however, a need for additional gas supplies in the United States. Increased exports of natural gas to the U.S. over limited periods of five to ten years would provide continued incentive for the exploration effort in Canada and would ease the balance of payments problem. There would no longer be the same urgency for the government to pursue gas substitution at any cost in order to reduce oil imports — so long as the latter continue to be readily available.

Let me make it clear, however, that the management of Gulf Canada agrees with the concept of gas substitution, so long as it can be done on a rational and economically-sound basis.

Energy Options

Looking now at the overall situation, Canada will face numerous problems in attaining its objective of energy self-reliance, but we are more fortunate than most industrial nations in that we have available to us many energy options we can pursue in order to meet our future energy requirements.

Let me review the principal options:

1. Continued exploration in the conventional areas of Western Canada.

2. Enhanced recovery of conventional oil reserves.

3. Continued exploration in the Arctic and offshore frontiers in order to assess what future supplies will be available.

4. Development of Western Canada's vast heavy oil deposits.

5. Additional projects in the oil sands.

6. Development of alternate energy sources, such as coal, nuclear and the more exotic renewable forms.

Conclusion

The important thing about the industry's recent discoveries of natural gas and conventional crude oil is that they have bought us a little more time, which I hope will be wisely used.

It is imperative that the industry and governments in Canada use the period afforded by our present adequate supplies to carefully assess the economic viability of the various energy alternatives available to us, so that priorities can be established for proceeding in a planned and orderly fashion.

It is only through such an approach that energy costs for Canadians can be minimized as we go through the process of ensuring that there will be adequate supplies to meet future needs.

Whichever energy options are pursued toward that end, we know that the total investment outlay required will be massive and totally unprecedented — an estimated 180 billion dollars in 1975 funds over the years to 1990 — of which the oil and gas industry is slated to spend at least half.

Our Company, which is about an eight per cent factor in the producing industry, will be expected to do its share of providing the investments required to meet future energy needs. We see in the challenges ahead a tremendous opportunity for Gulf Canada to grow and prosper and contribute to the further economic and industrial development of this country.

Directors

L. P. Blaser, *Toronto*
E. H. Crawford, *Toronto*
E. F. Crease, *Halifax*
J. Peter Gordon, *Toronto*
Dr. D. S. R. Leighton, *Banff*
J. C. Phillips, Q.C., *Toronto*
Gérard Plourde, *Montreal*
Alfred Powis, *Toronto*
Kathleen M. Richardson, *Winnipeg*
R. G. Rogers, *Vancouver*
C. D. Shepard, *Toronto*
J. L. Stoik, *Toronto*
W. P. Wilder, *Toronto*
W. H. Young, *Hamilton*

Director Emeritus

Beverley Matthews, Q.C., *Toronto*

Officers

C. D. Shepard, Chairman of the Board and Chief Executive Officer
J. L. Stoik, President and Chief Operating Officer
L. P. Blaser, Executive Vice-President
J. C. Phillips, Q.C., Executive Vice-President
W. P. Wilder, Executive Vice-President
S. G. B. Pearson, Senior Vice-President
R. C. Beal, Vice-President
*R. H. Carlyle, Vice-President
J. D. DeGrandis, Vice-President
W. H. Griffin, Vice-President
R. E. Harris, Vice-President
*E. M. Lakusta, Vice-President
S. K. McWalter, Vice-President
K. C. Reeves, Vice-President
C. G. Walker, Vice-President
W. M. Winterton, Vice-President, General Counsel and Secretary
W. H. Burkhiser, Treasurer
J. A. Scobie, Comptroller

*Located in Calgary

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Gulf

Gulf Oil Canada Limited

Report to Shareholders

For six months ended June 30, 1978

Gulf

GULF CANADA LIMITED

GULF CANADA LIMITED
CONSOLIDATED STATEMENT OF EARNINGS
(Unaudited Interim Report)

	Six Months Ended June 30 1978	1977
	(Millions of dollars)	
REVENUES:		
Gross sales and other operating revenues	$2,245.8	$2,015.0
Deduct — Crude oil sales	(833.7)	(741.4)
— Taxes collected for governments	(164.8)	(165.9)
Net sales and other operating revenues	1,247.3	1,107.7
Investment and sundry income	16.8	17.3
Net revenues	1,264.1	1,125.0
EXPENSES:		
Purchased crude oil, products and merchandise	664.7	566.3
Operating expenses	122.4	106.9
Exploration, dry hole and other frontier area expenditures	53.3	44.0
Selling, general and administrative expenses	160.0	143.6
Depreciation, depletion and amortization	47.5	41.7
Interest on long-term debt	12.8	9.7
	1,060.7	912.2
EARNINGS BEFORE INCOME AND OTHER TAXES	203.4	212.8
TAXES:		
Taxes other than taxes on income	62.4	58.6
Income taxes (includes deferred taxes of $41.5 in 1978; $29.2 in 1977)	53.5	63.1
	115.9	121.7
EARNINGS FOR THE PERIOD	$ 87.5	$ 91.1
Earnings per share	$ 1.92	$ 2.00
COMMON SHARES ISSUED	45,497,406	45,492,906

OPERATING STATISTICS

	Six Months Ended June 30 1978	1977
	(Daily volumes)	
Gross crude oil and natural gas liquids produced — barrels	109,784	117,283
Gross natural gas sold — thousands of cubic feet	415,544	454,311
Crude oil processed — barrels	323,871	337,015
Petroleum products sold — barrels	277,493	285,566

GULF CANADA LIMITED
CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION
(Unaudited Interim Report)

	Six Months Ended June 30 1978	1977
	(Millions of dollars)	
SOURCE OF FUNDS:		
From operations*	$ 177.0	$ 161.1
Sales of properties	4.4	5.4
Long-term obligations	30.5	149.1
Sales of investments	4.0	1.1
	215.9	316.7
USE OF FUNDS:		
Additions to property, plant and equipment	204.4	148.3
Reduction in long-term debt	2.5	8.6
Dividends	25.9	24.6
Other (net)	.6	3.0
	233.4	184.5
(Decrease) increase in working capital	(17.5)	132.2
Working capital, beginning of period	538.4	473.7
Working capital, end of period	$ 520.9	$ 605.9

*Earnings for the period adjusted for charges and credits not affecting working capital.

CONSOLIDATED STATEMENT OF WORKING CAPITAL
(Unaudited Interim Report)

	June 30 1978	1977
	(Millions of dollars)	
Cash and marketable securities	$ 109.8	$ 217.4
Accounts receivable	512.0	466.1
Inventories of crude oil, products and merchandise	499.7	430.8
Materials, supplies and prepaid expenses	43.7	36.1
Current assets	1,165.2	1,150.4
Short-term loans	27.7	26.0
Accounts payable and accrued liabilities	523.7	442.6
Income and other taxes payable	52.2	50.9
Current portion of long-term debt	27.7	12.7
Dividends payable	13.0	12.3
Current liabilities	644.3	544.5
Working capital	$ 520.9	$ 605.9

Toronto, Ontario, August 4, 1978

TO THE SHAREHOLDERS:

Earnings . . . Net earnings for the six months ended June 30, 1978, amounted to $87.5 million or $1.92 per share, compared with $91.1 million or $2.00 per share for the first half of 1977.

Natural resource profits were improved due to higher crude oil and natural gas prices. Earnings from refining and marketing operations continued to deteriorate, following the trend established earlier in the year as intensive competition in Eastern Canada precluded the full recovery of cost increases.

Capital and exploratory expenditures totalled $257.7 million, compared with $192.3 million in the first half of last year. Working capital decreased $17.5 million during the first six months of this year.

TAXES AND OTHER GOVERNMENT REVENUES

	Six Months Ended June 30 1978	1977
	(Millions of dollars)	
From Gulf Canada:		
Income taxes — current	$ 12.0	$ 33.9
— deferred	41.5	29.2
Other taxes	62.4	58.6
Petroleum and natural gas lease payments	23.9	11.1
Crown royalties, less incentive credits	90.0	82.9
	229.8	215.7
Collected for governments:		
Gasoline, fuel, excise and export taxes	164.8	165.9
GRAND TOTAL	$394.6	$381.6
NET EARNINGS AFTER TAXES	$ 87.5	$ 91.1

Exploration . . . Sixteen exploratory wells were drilled in the second quarter, 13 in the western provinces and three in the frontiers; of these, six were gas successes and three found heavy oil.

In the Beaufort Sea, Isserk E-27, drilled from an artificial island on acreage held 21.75 per cent by Gulf Canada, flowed significant volumes of gas from a drillstem test at 6,000 feet. Although abandoned, it is a potential gas well when the area is developed.

In the Arctic Islands, the Roche Point O-43 wildcat well, drilled from an ice platform off Melville's Sabine peninsula, flowed gas from a drillstem test at 20 million cubic feet per day. Gulf Canada has a 20 per cent working interest in the well, which is located 30 miles north of the Hecla gas field. The other 1978 Arctic Island well in which Gulf has an interest, Cape Grassy I-34, was plugged and abandoned.

In Alberta, gas was discovered near Magrath in the southern part of the province and at a delineation well north of the presently-defined productive trend in the foothills at Stolberg. In the Suffield area, an additional four wells discovered hydrocarbons – one gas and three heavy oil.

In British Columbia, a successful wildcat north of the Company's previous Trutch gas discovery extended the potential productive trend.

Production . . . Production of crude oil and natural gas liquids for the first six months averaged 109,800 barrels per day before royalty, about 7,500 barrels lower than the comparable period in 1977. The decrease reflects reduced industry demand for conventional crude oil as well as lower gas volumes from which natural gas liquids are recovered.

Daily natural gas sales from Gulf Canada reserves averaged 403 million cubic feet, down

35 million cubic feet from 1977 as a result of the current oversupply situation. The Company's major gas purchaser gained industry support to voluntarily limit production to 80 per cent of minimum contractual obligations in lieu of a forced prorationing scheme. The effect of this action is to allocate sales equitably and to maintain Gulf Canada's share of the market.

A sulphur-forming project, scheduled to be operating by mid-1979, was approved for the Strachan gas plant to convert liquid production as well as block sulphur inventory into prills. This forming process will meet more stringent environmental regulations related to the transportation and handling of bulk sulphur.

Nineteen development wells drilled during the quarter in Western Canada included eight oil and seven gas successes. The oil wells improved reserves at Ricinus, South Swan Hills and Wimborne while the additional gas wells developed reserves in northern Alberta and in the foothills. Eight more development wells were being drilled at the end of the quarter.

In heavy oil operations, construction of the fireflood project at Wabasca in northern Alberta is now complete and the injection well has been ignited. At Cold Lake, steam is being injected into six wells and production to date has amounted to 30,000 barrels, with some wells producing at peak rates in the range of 200 barrels per day. Preliminary engineering is now underway to develop heavy oil acreage recently acquired at Surmont.

An agreement was signed with Denison Mines Ltd. in April in which Gulf Canada purchased a 40 per cent interest in Denison's Belcourt metallurgical coal property in northeastern British Columbia. An intensive exploration program and feasibility study has already begun.

Operating difficulties in the Syncrude project resulted in a delay in the production of synthetic crude. It now appears that the problems have been resolved and, with construction of the

facilities 99 per cent complete, production is scheduled to start in late July.

Supply and Distribution . . . At a June meeting, the Organization of Petroleum Exporting Countries agreed to continue the freeze on foreign crude oil prices to the end of this year. Domestic crude oil and condensate prices held firm from February until July 1 when they were increased by $1.00 per barrel.

A trial cargo of Mexican crude oil purchased from Mexico's national oil company is currently being processed at the Montreal East refinery.

Refining . . . Second-quarter crude and condensate throughput totalled 28 million barrels or 80.3 per cent of capacity, a decrease of 2.1 million barrels from the same period last year.

At Clarkson refinery, construction of the new lube oil production facilities is almost complete and testing of the units is underway. The compounding, blending and grease plant expansion, including a new computerized high rise warehouse, is also undergoing tests.

Chemicals . . . Although second-quarter sales increased over last year, earnings declined as higher feedstock costs were only partially passed on to customers.

Marketing . . . Sales volumes in the quarter showed no gain over 1977 in a market that is growing only one to two per cent a year.

Prices continue to be extremely competitive in Eastern Canada, in some cases not covering the full costs of manufacturing the products. To offset this profit squeeze, marketing emphasis is on further improving efficiency and stressing those market segments where reasonable returns can be made.

Realty . . . The Gulf Canada Square project in Calgary continues to make good progress. By the end of June the tower structure had risen to the tenth floor.

Chairman of the Board.

President.

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Crude, Gas Volumes Down
In Gulf Canada First Half

Aug 4, 1978

TORONTO -- Although Gulf Canada's resource earnings increased slightly in the first six months of 1978, due to higher prices, production levels declined from the first half last year.

Production of crude oil and natural gas liquids for the first six months of 1978 averaged 109,800 barrels per day before royalty, about 7,500 daily barrels lower than the comparable 1977 period.

Daily natural gas sales from Gulf Canada reserves averaged 403 million cubic feet, a decrease of 35 million cubic feet from the first six months of 1977 as a result of the current industry over-supply situation. The company said the voluntary production limit of 80 per cent of minimum contract requirements obtained from Gulf Canada and other producers by the major gas purchaser, TransCanada PipeLines, would allocate sales equitably and maintain Gulf Canada's industry position.

As reported previously, Gulf Canada's six-month net earnings amounted to $87.5 million or $1.92 per share, down four per cent from the $91.1 million or $2.00 per share in the first half of 1977. Capital and exploratory expenditures for the period were up by $65.4 million to $257.7 million. Working capital, on the other hand, decreased by $17.5 million in the first half of this year.

During the second quarter, the company drilled 13 exploratory wells in Western Canada and three in the frontiers, of which six discovered gas and three found heavy oil.

In the Beaufort Sea, Isserk E-27, drilled from an artificial island on acreage held 22 per cent by Gulf Canada, flowed significant quantities of gas from a drillstem test at 6,000 feet. The well has been abandoned but is a potential gas well when the area is developed, the company says.

In the Arctic islands, the Roche Point 0-43 wildcat well, drilled from an ice platform off Melville's Sabine peninsula, has flowed gas from a drillstem test at 20 million cubic feet per day. Gulf Canada has a 20 per cent working interest in the well, located 30 miles north of the Hecla gas field. The other 1978 Arctic island well in which Gulf Canada has an interest, Cape Grassy I-34, was plugged and abandoned.

In Alberta, gas was discovered in the Magrath area in the southern part of the province. In the foothills at Stolberg, a delineation well north of the presently-defined productive trend found gas. Drilling in the Suffield area produced one gas success and three heavy oil finds.

In British Columbia, a wildcat well north of the company's previous Trutch gas discovery was successful in extending the potential productive trend.

Nineteen development wells drilled in Western Canada during the second quarter resulted in eight oil and seven gas successes. The oil wells increased the company's reserves in the Ricinus, South Swan Hills and Wimborne fields, while the gas wells developed reserves in northern Alberta and the deep plains region of the foothills.

Construction of the company's fireflood heavy oil pilot project was completed at Wabasca in Alberta, and the injection well was ignited. At the Cold Lake project, steam is being injected into six wells. Production to the end of the second quarter amounted to 30,000 barrels, with some wells reaching peak rates of over 200 barrels per day.

Preliminary engineering is underway to develop a drilling program for the Surmont heavy oil acreage acquired under an agreement with Numac Oil and Gas Ltd.

An intensive exploration program and feasibility study is underway on Denison Mines' Belcourt metallurgical coal property in northeastern British Columbia, in which Gulf Canada has a 40 per cent interest.

With refined product sales almost flat in a market now estimated to be growing at only two per cent a year, marketing emphasis is on further improving efficiency and stressing those market segments where reasonable returns can be made.

Gulf Canada's new lubricating oil production facilities at Clarkson refinery are 95 per cent complete, and various units are being commissioned. The new plant, scheduled to be operating this fall, will have the capacity to supply almost one-quarter of Canada's lubricating oil needs.

During the first six months refineries processed over 58 million barrels of crude oil and condensate, or 84 per cent of capacity, a decrease of two million barrels from the first half of 1977 due to reduced gasoline and middle distillate demands.

Computerized control of refinery operations is nearing completion at both Edmonton and Port Moody. A trial cargo of Mexican crude oil was received at the Montreal East refinery for evaluation as a possible alternative source of imported oil.

August 4, 1978

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